# Looking Towards Tomorrow's Health

## Annual Report 2016

For the Year Ended March 31, 2016

KISSEI

## Profile

Since its establishment in 1946, the Kissei Group has been expanding its business from the Matsumoto area in Shinshu to countries and regions across the globe.

With the pharmaceutical business function as its core, the Group has contributed to the health and medical treatment of people around the world through the development and provision of high-quality products.

Guided by its firm belief that a pharmaceutical company cannot exist without R&D, which has been passed on since its founding, the Group strives to develop new drugs on a daily basis in the hope that such drugs will allow as many people as possible to promptly recover from illness and lead lives filled with laughter and joy.

By constantly incorporating the progress made in life sciences and relentlessly taking on challenges in drug discovery, the Group will continue to develop and provide original pharmaceuticals to further improve global health.

### Contents

## History

| | |
|---|---|
| **Aug. 1946** | Founded as Tachibana Seikagaku Institute Co., Ltd. |
| **May 1947** | Changed corporate name to Kissei Yakuhin Kogyo Co., Ltd. |
| **Dec. 1961** | Launched Gascon, a gastrointestinal anti-gas agent |
| **Oct. 1964** | Changed corporate name to Kissei Pharmaceutical Co., Ltd.<br>Constructed Head Office and factories at present location (Matsumoto City) |
| **May 1969** | Construction of Central Research Laboratories (Matsumoto City) |
| **Jul. 1980** | Constructed Manufacturing Plant |
| **Aug. 1982** | Launched Rizaben, a drug for the treatment of allergic diseases |
| **Jun. 1985** | Constructed Toxicological Laboratories (Azumino City) |
| **Aug. 1986** | Launched Utemerin, a drug for threatened premature labor and threatened abortion |
| **Dec. 1988** | Listed on the Second Section of the Tokyo Stock Exchange |
| **Apr. 1990** | Established Foodstuff Business Unit<br>Launched Jellix, a low-energy jelly |
| **Nov. 1990** | Moved Central Research Laboratories (Azumino City) |
| **Apr. 1991** | Launched Bezatol, a drug for the treatment of hyperlipidemia |
| **Sep. 1991** | Listed on the First Section of the Tokyo Stock Exchange |
| **Oct. 1994** | Constructed Shiojiri Plant (Shiojiri City) |
| **Jul. 1995** | Established Tokyo Head Office (Nihonbashi) |
| **Sep. 1996** | Constructed Pharmaceutical Laboratories (Azumino City) |
| **Mar. 1997** | Established the second Tokyo Head Office (Koishikawa) |
| **Oct. 1997** | Established the subsidiary Kissei U.S.A., Inc. |
| **May 2001** | Constructed Nutritional Business Center (Shiojiri City) |
| **Apr. 2004** | Reorganized U.S.-based companies Established Kissei America, Inc. |
| **May 2004** | Launched Glufast, a drug for the treatment of type 2 diabetes |
| **Mar. 2005** | Launched Yume Series protein controlled foods and Macton Series energy supply foods |
| **May 2006** | Launched Urief, a drug for the treatment of dysuria associated with benign prostatic hyperplasia (BPH) |
| **Apr. 2007** | Constructed Joetsu Chemical Laboratories (Joetsu City) |
| **Dec. 2008** | Launched New through-king i, a viscosity modifier |
| **Apr. 2009** | Launched silodosin (brand name in Japan: Urief), a drug for the treatment of dysuria associated with BPH, in the United States |
| **Apr. 2010** | Constructed new main building of Head Office (Matsumoto City) |
| **May 2010** | Launched Epoetin Alfa BS Injection [JCR], a drug for the treatment of renal anemia |
| **Mar. 2011** | Launched Genta Soy Sauce, a protein controlled, low-salt soy sauce |
| **Jul. 2011** | Launched Glubes, a drug for the treatment of type 2 diabetes |
| **Nov. 2015** | Launched P-TOL, a drug for the treatment of hyperphosphatemia |

# Letter from the CEO

## As an R&D-oriented company that can create new, original value, we will contribute to the healthy and affluent lifestyles of people around the world without forgetting the origin of our corporate activities.

Guided by its management philosophy, the Kissei Group is aiming to make significant contributions to society. The Group promotes management policies that emphasize the importance of shareholders, employees, local communities, history and culture, and the environment. The management vision underpinning its core pharmaceutical business challenges Kissei Pharmaceutical Co., Ltd. (Kissei), to be an R&D-oriented pharmaceutical company that contributes to the health of people around the world through innovative drug products. To this end, Kissei is pushing forward with patient-centered measures including the undertaking of R&D activities, high-quality manufacturing, the collection and provision of information necessary for the optimum use of its products, the implementation of efficient operations, and the construction of a total marketing system. In addition, each Kissei Group company assists in our pharmaceutical business and leverages its technologies to help develop our operations both domestically and internationally.

In August 2016, Kissei celebrated its 70th anniversary. The Company was founded shortly after the end of World War II. At the time, we faced various hardships as we sought to realize self-reliance as a company. Under these circumstances, we created our management philosophy of “contributing to society through high-quality, innovative pharmaceutical products” and “serving society through our employees.” Even though the path before us was steep, we dedicated the Company’s existence to developing new drugs and, by adhering to the principles of our management philosophy, were able to grow into a company that manufactures new drugs not only in Japan but also on a global basis.

Throughout our history, the operating environment we face has constantly changed. Particularly in recent years, severe changes are occurring that have exceeded the expectations of new drug manufacturers like ourselves. In addition to significant global trends, such as the decreasing probability of successfully creating new drugs and the changes to the market structure itself, there has been a strong push in Japan for national policies to reduce drug costs in order to curtail medical expenses. The impact of generic drugs on long-listed drugs is rapidly increasing, and the profitability of long-listed drugs, which have been an important source of profits for new drug manufacturers in Japan, is therefore significantly decreasing. Going forward, with the country’s rapidly aging and decreasing population as well as its declining

## Medium-Term Management Plan, PROGRESS 3

Period: April 2014 – March 2017 (three years)

### Management Vision

To be an R&D-oriented pharmaceutical company that contributes to the health of people around the world through innovative drug products

### Basic Strategies

1. Enhance and strengthen our product portfolio
2. Effectively advance development themes and steadily acquire approvals
3. Establish a competitive edge and increase sales in the domestic market
4. Promote overseas development and increase overseas profits
5. Establish an effective production system and realize a stable supply
6. Secure profits and expand businesses in the healthcare field

### Numerical Targets for Fiscal 2016

| | |
|---|---|
| Consolidated net sales | ¥ 71.0 billion |
| Non-consolidated net sales | ¥ 61.0 billion |
| Consolidated operating income | ¥ 8.6 billion |

| | |
|---|---|
| Pharmaceuticals | ¥50.5 billion |
| Health Foods | ¥ 3.8 billion |
| Other* | ¥ 6.7 billion |

* Other refers to the total of supply to domestic business partners and revenue from technical fees (contract fees from out-licensing of R&D themes, milestone income, and running royalties).

birthrate, the Japanese government is expected to reinforce various measures to curtail drug costs in order to secure the sustainability of the fast-growing social security system.

Amid these circumstances, new drug manufacturers have been given the role of "creating new, innovative drugs that can be expanded worldwide" under the Japanese government's comprehensive strategy to strengthen the pharmaceutical industry. In addition, policies are being hammered out to support the further creation of new and innovative drugs, such as the establishment of the Japan Agency for Medical Research and Development. Accordingly, it has now become the mission of new drug manufacturers to develop high-quality new drugs and continually deliver them to patients. In this way, new drug creation will be an essential condition to surviving as a company going forward. As such, we have formulated our medium-term management plan, PROGRESS 3 (fiscal 2014–fiscal 2016) to serve as a concrete roadmap for realizing our management philosophy and are engaging in a variety of initiatives under this plan.

In fiscal 2016, the last year of PROGRESS 3, we view the plan's basic strategy of "enhancing and strengthening our product portfolio" as our most important task and are actively carrying out investments to realize effective R&D and licensing activities. We are confident in Kissei's ability to keep growing as an R&D-oriented pharmaceutical company by implementing these kinds of concrete growth strategies.

Kissei aims to always be a highly trusted company that lives up to the expectations of all its stakeholders, including patients, patients' families, and medical practitioners as well as its shareholders and employees and the local communities it serves. To accomplish this goal, we will relentlessly pursue our quest to realize Kissei's management vision while forging a path for creating future value through never-ending innovation.

I hope for the ongoing support of all our stakeholders as we advance into the future.

June 2016

Mutsuo Kanzawa
Chairman and Chief Executive Officer

# Message from the COO

Masaki Morozumi

President and Chief Operating Officer

## Review of Operations

### Overview of Operations in the Year Under Review

In fiscal 2015, the year ended March 31, 2016, the Japanese economy came to a standstill as the economic decline in the Eurozone as well as in China and emerging nations brought an end to the momentum of yen deprecation, which in turn negatively impacted the stock market. As a result, the future prospects for the Japanese economy remain unclear.

In the pharmaceutical industry, business conditions remained difficult as market competition between companies intensified and the Japanese government continued the promotion of policies to encourage the use of generic drugs in order to reduce public medical treatment costs. Demand for IT investment and capital investment gradually recovered among companies in the information services, merchandising, and construction industries. Nonetheless, economic stagnation intensified, primarily due to sluggish consumer spending, and the Company continued to remain in a fierce competitive environment.

In the pharmaceutical business, net sales increased 3.6% year on year, to ¥61,822 million. While sales of long-listed drugs were down, we aggressively promoted activities to spread medical information about our mainstay products, such as Urief®, a drug for the treatment of dysuria associated with benign prostatic hyperplasia (BPH); the Glubes® combination tablet and Glufast®, both used to treat type 2 diabetes; and Epoetin Alfa BS injection [JCR], a drug for the treatment of renal anemia. In addition, revenue from technical fees and supply to domestic business partners increased. These factors contributed to the increase in sales. Also, we launched P-TOL® chewable tablets, a drug used to treat hyperphosphatemia, and Urief® OD tablets, an additional dosage form of Urief®, in November 2015 and January 2016, respectively. Furthermore, licensed companies continued to move forward with measures to expand silodosin (generic name, brand name in Japan: Urief®), a drug for the treatment of dysuria associated with BPH, in the countries and regions in which they are licensed to do so. In the year under review, U.S.-based licensee Allergan plc advanced these measures in North America and Latin America, and Italy-based licensee Recordati S.p.A. advanced these measures in Europe, the Middle East, and Africa.

In other businesses, net sales fell 9.1% year on year, to ¥9,472 million. Although sales were up in the information services industry, sales declined in both the merchandising and construction industries.

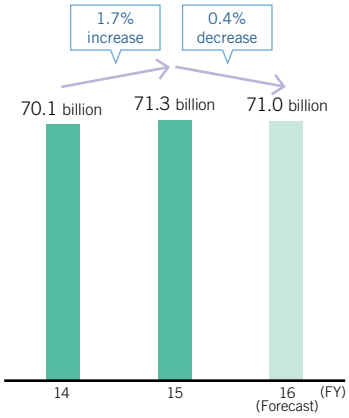
Turning to income, sales increased while the cost of sales ratio decreased. In addition, selling, general and administrative (SG&A) expenses, primarily R&D expenses, were down. As a result, the Company saw an increase in both operating income and profit attributable to owners of parent.

As for R&D, in the year under review we received approval for an additional dosage form of Glufast® oral disintegration tablets in February, and launched the drug in June after it was listed on the National Health Insurance (NHI) price list. Furthermore, in March we entered into an agreement with KYORIN Pharmaceutical Co., Ltd., for the collaborative development and marketing of KRP-114V (development code, generic name: vibegron), a drug for the treatment of overactive bladder (OAB), in Japan. While we have advanced collaborative research with U.S.-based Pfizer Inc. for new compounds to replace KUX-1151 (development code), a drug used to treat gout and hyperuricemia for which the Company licensed out to Pfizer, we have decided not to continue this research during the year under review due to the fact that Pfizer has revised its R&D portfolio.

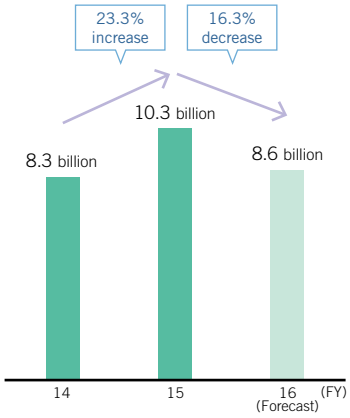
Additionally, we entered into an agreement granting exclusive rights to Switzerland-based ObsEva SA to develop and market KLH-2109 (development code), an endometriosis treatment that the Company discovered in November 2015, in countries around the world, excluding some countries in Asia, such as Japan.

## Business Results and Forcast For Fiscal 2016

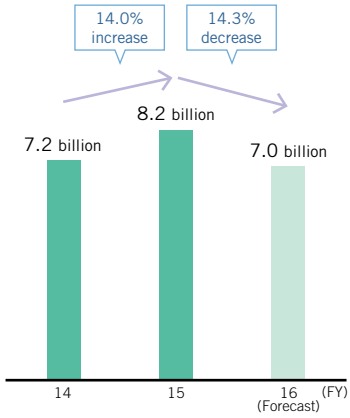
**Net Sales**




**Operating Income**




**Profit Attributable to Owners of Parent**




## Outlook for the Current Fiscal Year

In the domestic pharmaceutical market, business conditions will likely remain difficult as the Japanese government continues the promotion of policies to reduce public medical treatment costs, such as encouraging the use of generic drugs.

Despite signs of economic recovery emerging, other businesses are also expected to continue facing challenging conditions in their respective industries.

Amid these conditions, the Kissei Group will focus its efforts on strengthening its management base through the creation of synergies among Group companies. At the same time, the Group will work to improve profitability going forward by fully capitalizing on the milestones it has made in investments toward R&D and other areas.

### Net Sales

In the pharmaceutical business, we will continue efforts to cultivate Urief®, Glubes®, P-TOL®, and Epoetin Alfa BS. However, we are expecting a decrease in net sales due to the impact of drug price revisions implemented in April as well as the anticipated decline in revenue from technical fees. In other businesses, we forecast an increase in sales.

Overall, as we launched P-TOL® a year ahead of schedule, we are expecting to secure a business performance in fiscal 2016 that is in line with the initial plans for the final year of our medium-term management plan.

### Income

For the pharmaceutical business, we are expecting a decrease in operating income following a decline in sales and an increase in the cost of sales ratio, despite lower SG&A expenses due to a decrease in R&D expenses. In other businesses, while we anticipate an increase in sales, operating income will likely decline due the rising cost of sales ratio. Furthermore, we do not anticipate any noteworthy changes to non-operating income and extraordinary income.

Overall, we are anticipating the performance of operating income in fiscal 2016 to be below that of initial plans for the final year of the medium-term management plan due to increases in SG&A expenses, primarily R&D expenses.

## Management Strategy

Kissei aspires to be an R&D-oriented pharmaceutical company. In fiscal 2014, the Company began its medium-term management plan, PROGRESS 3. By advancing the basic strategies of the plan listed on page 3, we will work to strengthen our earnings structure and establish foundations for future growth.

We recognize that reinforcement and enhancement of a product portfolio with a high level of originality and competitiveness is an important management issue. Under PROGRESS 3, we will conduct tasks such as the selection of drug discovery themes, introduction of newly developed and existing products, development of biopharmaceutical operations, and institution of lifecycle management in a balanced manner while considering marketing and intellectual property strategies. In addition, we will expand our R&D pipeline to enable us to continuously introduce new products to the market.

Furthermore, to support future investments we realize the necessity of enhancing operational efficiency and improving productivity through cost reductions in conjunction with the promotion of activities under the plan. Additionally, we will work to establish a lively corporate culture and a meaningful working environment for our employees as well as promote initiatives to develop the human resources who will oversee the Company's future. At the same time, we will strive to fulfill our mission as a company involved in life sciences through the appropriate management of corporate governance and internal control systems as well as the promotion of our Compliance Program.

Going forward, we would like to ask for the continued understanding and support of our stakeholders.

June 2016

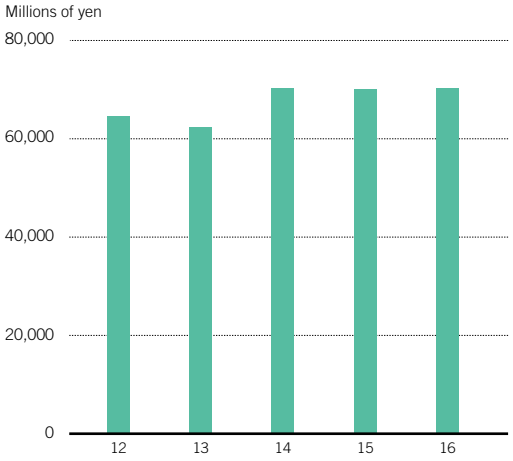
# Financial Highlights

Kissei Pharmaceutical Co., Ltd. and its subsidiaries
Years ended March 31

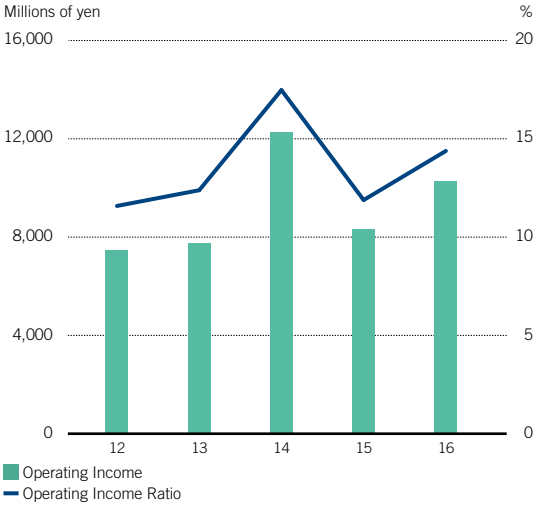
| | Millions of yen, except per share data | | | | | Thousands of U.S. dollars, except per share data[1] |
|---|---|---|---|---|---|---|
| | 2012 | 2013 | 2014 | 2015 | **2016** | **2016** |
| **For the Year:** | | | | | | |
| Net Sales | ¥64,619 | ¥62,491 | ¥70,399 | ¥70,111 | **¥71,294** | **$630,920** |
| R&D Expenses | 10,043 | 10,312 | 11,299 | 14,488 | **14,106** | **124,832** |
| Capital Investment | 1,893 | 1,664 | 2,382 | 1,825 | **1,942** | **17,186** |
| Operating Income | 7,466 | 7,761 | 12,301 | 8,334 | **10,274** | **90,921** |
| Profit Attributable to Owners of Parent | 4,770 | 5,020 | 9,093 | 7,165 | **8,165** | **72,257** |
| **At Year-End:** | | | | | | |
| Total Assets | ¥144,385 | ¥160,028 | ¥172,650 | ¥181,485 | **¥193,346** | **$1,711,027** |
| Total Net Assets | 123,386 | 134,784 | 142,821 | 150,720 | **158,125** | **1,399,337** |
| **Per Share (Yen and U.S. Dollars):** | | | | | | |
| Profit Attributable to Owners of Parent[2]: | | | | | | |
| Primary | ¥91.4 | ¥97.5 | ¥176.7 | ¥142.1 | **¥166.9** | **$1.477** |
| Fully Diluted | — | — | — | — | **—** | **—** |
| Cash Dividends | 36.0 | 38.0 | 40.0 | 42.0 | **44.0** | **0.389** |
| **Key Ratios (%):** | | | | | | |
| Operating Income Ratio | 11.6 | 12.4 | 17.5 | 11.9 | **14.4** | |
| R&D Expenses Ratio | 15.5 | 16.5 | 16.0 | 20.7 | **19.8** | |
| Return on Assets (ROA) | 3.3 | 3.1 | 5.5 | 4.0 | **4.4** | |
| Return on Equity (ROE) | 3.9 | 3.9 | 6.6 | 4.9 | **5.3** | |
| Shareholders' Equity Ratio | 85.3 | 84.1 | 82.6 | 82.9 | **81.6** | |
| Dividend Payout Ratio | 39.4 | 39.0 | 22.6 | 29.5 | **26.4** | |
| **Non-Financial Data:** | | | | | | |
| Number of Employees | 1,893 | 1,894 | 1,883 | 1,883 | **1,908** | |
| Energy Used (kL) | 9,455 | 9,092 | 9,232 | 9,256 | **9,281** | |
| $CO_2$ Emissions (t) | 20,152 | 20,306 | 20,843 | 20,916 | **20,695** | |
| Amount of Waste Generated (t) | 476 | 415 | 406 | 439 | **398** | |
| Number of Shares Issued | 56,911,185 | 56,911,185 | 56,911,185 | 56,911,185 | **54,311,185** | |

1: U.S. dollar amounts are translated at the rate of ¥113=U.S.$1, the approximate effective rate of exchange at March 31, 2016.
2: Profit attributable to owners of parent per share is computed based on the weighted-average number of shares of common stock after subtracting the weighted-average number of shares of treasury stock for the year.

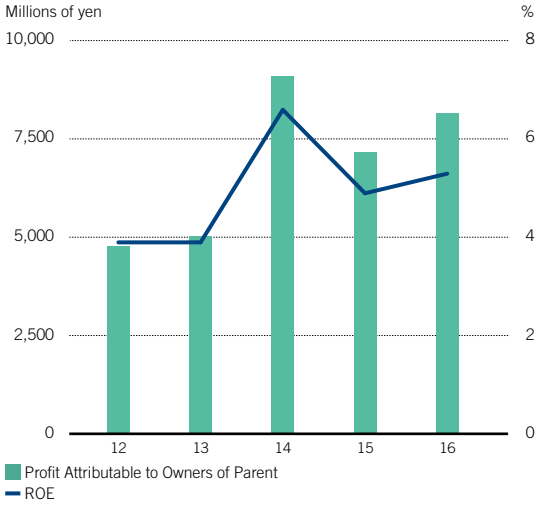
## Net Sales



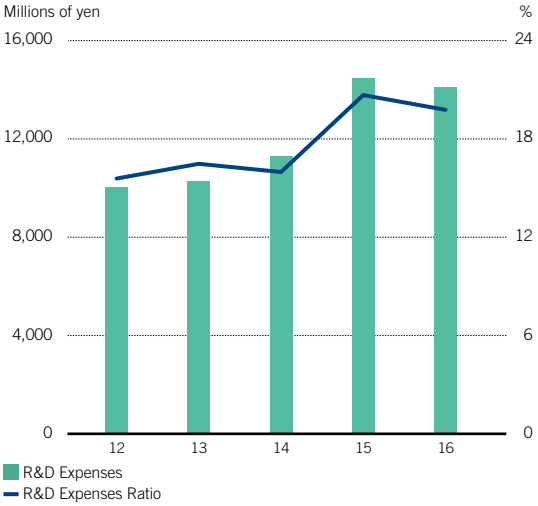

## Operating Income / Operating Income Ratio



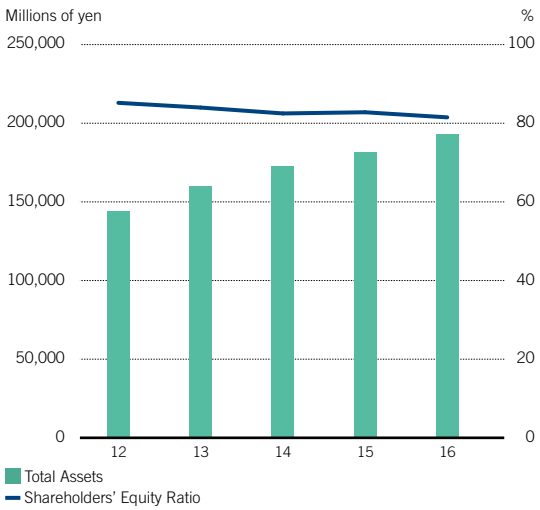

## Profit Attributable to Owners of Parent / ROE



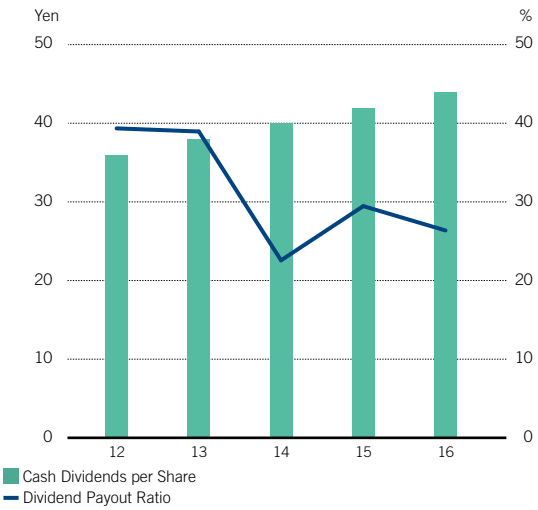

## R&D Expenses / R&D Expenses Ratio




## Total Assets / Shareholders' Equity Ratio




## Cash Dividends per Share / Dividend Payout Ratio



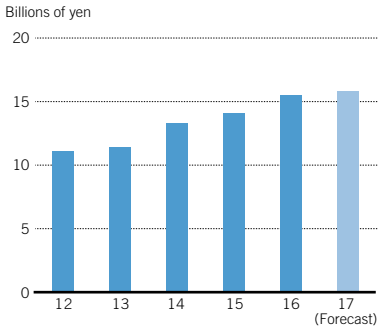
# Major Domestic Pharmaceuticals

## Dysuria treatment: Urief® Tablet and OD Tablet

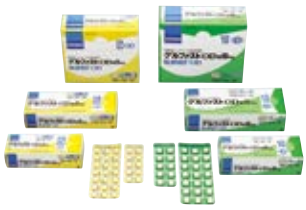
Urief® is a selective alpha 1A-adrenoceptor blocker developed by Kissei for the treatment of dysuria associated with BPH. By blocking alpha 1A-adrenoceptors in the prostate gland, it removes the tension of the prostate gland to improve urethral resistance. It has been co-marketed with Daiichi Sankyo Co., Ltd., since sales began in May 2006. Sales of Urief® in the form of an orally disintegrating (OD) tablet commenced in January 2016.

Years ended March 31

**Urief® Sales**

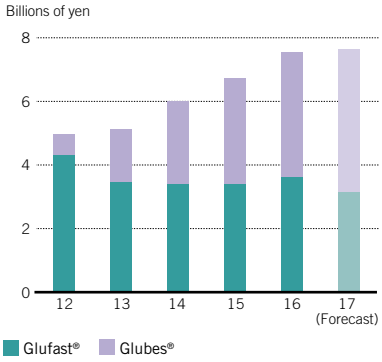



## Diabetes treatment: Glufast® Tablet and OD Tablet



Glufast® is a rapid-acting insulin secretagogue developed by Kissei that has been co-marketed with Takeda Pharmaceutical Co., Ltd., since May 2004. In September 2013, a partial revision to the indication for this agent was approved. It is now approved for treatment of type 2 diabetes, and can be used in conjunction with all oral hypoglycemic agents except sulfonylurea derivatives. Sales of Glufast® in the form of an OD tablet commenced in June 2016.

**Glufast® and Glubes® Sales**



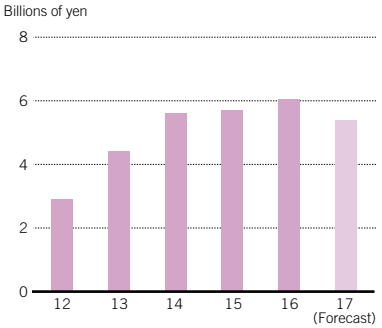

## Diabetes treatment: Glubes® Combination Tablet

The Glubes® Combination Tablet, a combination of Glufast® and voglibose (generic name), was first sold in July 2011 by Kissei, acting independently. The tablet has been highly praised for providing aggressive treatment of postprandial glucose increases as well as being easy to administer and for reducing the economic burden on patients.

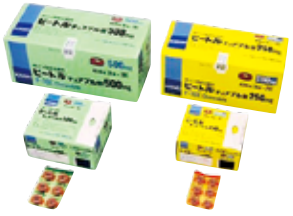
## Renal anemia treatment: Epoetin Alfa BS Injection [JCR]

Epoetin Alfa BS Injection [JCR] is a bio-similar recombinant human erythropoietin developed together with JCR Pharmaceuticals Co., Ltd. It has been co-marketed since May 2010.

**Epoetin Alfa BS Injection [JCR] Sales**




## Hyperphosphatemia treatment: P-TOL® Chewable Tablet



In November 2015, Kissei launched P-TOL® chewable tablets, a drug used to treat hyperphosphatemia in patients on dialysis. P-TOL® decreases serum phosphate concentration by binding oxyhydroxide with phosphoric acid in the gastrointestinal tract and reducing internal phosphate absorption.

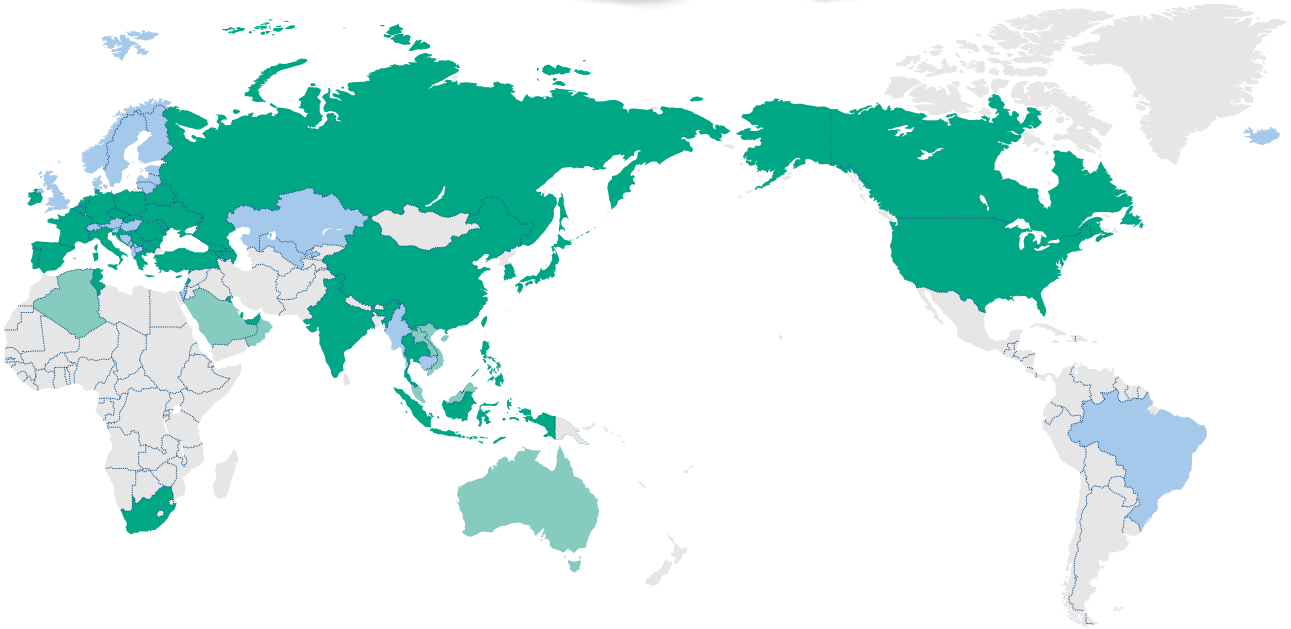
Overseas, Swiss-based Vifor Fresenius Medical Care Renal Pharma Ltd., the licensing company of P-TOL®, has received approval for P-TOL® in 35 countries around the world and is currently marketing the drug under the brand name Velphoro® in the United States, Europe, and other countries and regions.

# Overseas Development

## Overseas Development of Silodosin

As of July 2016

- Launched : 42 countries
- Approval acquired but not yet launched : 26 countries
- Filed an NDA but not yet approved : 10 countries

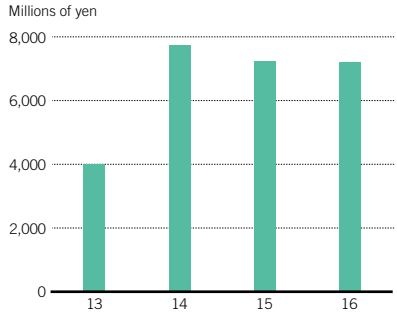



Silodosin, a drug for the treatment of dysuria, has earned a strong reputation around the world for its superior ability to relieve symptoms shortly after application. This drug was launched in the United States in April 2009 by licensing partner Watson Pharmaceuticals, Inc. (currently Allergan plc), under the brand name Rapaflo®. To date, this company has received additional licensing rights to sell the drug in 19 countries throughout the Americas. Futhermore, the drug was introduced in Germany in June 2010 under the brand name UROREC® by licensing partner Recordati S.p.A., of Italy. Recordati has received additional licensing rights to sell the drug in 84 countries and regions such as Europe, the Middle East, Africa, and Oceania. In April 2013, licensing partner Daiichi Sankyo (Japan) began selling the drug in China through a local subsidiary under the name Youlifu®.

Silodosin sales are rising as the number of countries it is sold in gradually increases. Silodosin has now been launched in 42 countries, including Japan, and is thus contributing to improving the quality of life of patients around the world.

Years ended March 31

**Past Exports***




* "Exports" is the total for overseas sales and revenue from dispensing fees (based on financial results).

## Out-Licensing of KLH-2109 (Development Code) to ObsEva SA

In November 2015, Kissei entered into an agreement granting exclusive rights to Switzerland-based ObsEva SA to develop and commercialize the novel investigational drug KLH-2109 (development code), an endometriosis treatment discovered by the Company.

Under this agreement, Kissei grants ObsEva exclusive worldwide rights to KLH-2109, excluding some countries in Asia, such as Japan. The Company will receive an upfront payment from ObsEva and will be eligible to receive milestone payments according to development stage. In addition, the Company will supply drug substances to ObsEva.

KLH-2109 is a new orally administrable GnRH (gonadotropin-releasing hormone) antagonist. The agent acts by antagonizing GnRH at the GnRH receptor located in the pituitary gland, thereby suppressing the secretion of gonadotropin, a gonadotropic hormone. The agent is currently under phase II clinical trials in Japan.

Kissei is focusing its efforts on R&D for new drugs and aims to expand globally by out-licensing its original products overseas. Going forward, Kissei will continue to actively develop new drugs that can contribute to the health of people around the world.

# R&D

As an R&D-oriented pharmaceutical company, Kissei aims to develop and provide innovative drug products by investing management resources predominately in research on drug discovery. The driving force behind the Company's R&D efforts is the desire to help patients who are suffering from illnesses and contribute to the health of people around the world.

We have adopted "enhance and strengthen our product portfolio" as the first strategic theme of our medium-term management plan, PROGRESS 3. Based on this theme, we have proactively invested in R&D and worked to realize effective licensing activities. Under the current medium-term management plan, we have added KDT-3594, a drug discovered in our laboratories, and have introduced three new drugs (AJM300, AJG511, and KRP-114V), into the development pipeline. In these ways, we are steadily working toward achieving the goals of the plan's strategic themes.

In addition, we are reinforcing our research foundation and are promoting R&D for biopharmaceuticals in order to create highly competitive products that display the Company's significance.

Going forward, the creation of new drugs is expected to become more and more difficult due to such factors as the reduction of drug discovery "seeds," the lengthening of development periods, and the steep rise in R&D costs. In order to realize sustainable growth amid this difficult environment, we are actively cooperating with pharmaceutical companies both in Japan and overseas as well as venture companies with the purpose of leveraging external technology and drug discovery "seeds." Furthermore, we are making concerted efforts to bolster our domestic sales structure and improve our management cost structure to secure R&D resources.

## R&D Process for Pharmaceuticals

The R&D process for pharmaceuticals involves four stages: discovery research, pre-clinical studies, clinical trials, and approval. It takes approximately 9 to 17 years for one drug to launch on the market with a success rate of about one out of 30,000 candidate compounds.

In the discovery research stage, we make free use of a variety of scientific technologies, such as synthesis technology and biotechnology, to investigate and discover compounds that could potentially be candidates for new drugs. We also use natural raw materials (plants, animals, microbes, etc.) to extract and identify such compounds. Furthermore, we investigate the properties and chemical structure of new compounds and select or reject these compounds through screening processes. The next stage of the R&D process is pre-clinical studies, which involves investigating the efficacy and safety of the newly discovered compound from a non-clinical perspective. In this stage, data on the compound's efficacy and safety is comprehensively analyzed and studies are performed to assess the compound's quality.

Once the efficacy and safety of the compound are confirmed through pre-clinical studies, we proceed to the clinical trial stage, which consists of three phases. After completing all three phases of clinical trials, we submit an application for the compound's approval based on the clinical trial results. Compounds that are approved after passing through the stringent review process of Japanese authorities are then launched on the market as new drugs.

## Kissei's Initiatives in Each Stage of the R&D Process

Discovery research–Pre-clinical studies: We focus our efforts on selecting highly original targets that can contribute to medical care, in addition to creating superior drug candidates and establishing evaluation systems for those compounds. For the establishment of cutting-edge, in silico drug-design technologies and screening systems, evaluations of efficacy, pharmacokinetics, and safety, we incorporate external information from academic institutions and JPMA (Japan Pharmaceutical Manufacturer's Association) consortiums. At the same time, we make proactive efforts to introduce the latest technologies, including those related to iPS cells. Furthermore, in addition to our own research we actively promote collaboration with research institutions, including universities both in Japan and overseas, as well as cooperation with venture companies that possess innovative technologies, in order to continuously create new drugs. Through these means, we endeavor to create innovate medicine based on advanced science.

Clinical trial–Approval: From the early stages of development we establish a target product profile (TPP) based on scientific analysis of clinical trial results. After ascertaining a compound's marketability and probability of success, we decide which compounds to prioritize and advance development accordingly. In addition, we effectively utilize outside resources such as contact research organizations. In these ways, we aim to promptly and steadily receive approval for our compounds.

Kissei strictly adheres to the Good Laboratory Practice, Good Manufacturing Practice for Investigational Product, and Good Clinical Practice standards as set by Japanese authorities. At the same time, Kissei has enacted Rules Regarding the Research Ethics Committee in accordance with the "Ethical Guidelines for Medical and Health Research Involving Human Subjects" and is engaging in R&D under high ethical standards.

## R&D Pipeline

As of July 2016

### In-House

| Development Stage | Product Name / Generic Name / Development Code | Development Classification | Therapeutic Target |
|---|---|---|---|
| Phase III | Rovatirelin / KPS-0373 | In-licensed / Shionogi (Japan) | Spinocerebellar ataxia<br>- Product mimetic of TRH action - |
| | Carotegrast Methyl / AJM300 | In-licensed / Co-development with EA Pharma (Japan) | Ulcerative colitis<br>- Alpha 4 integrin antagonist - |
| | Budesonide / AJG511 | In-licensed / Co-development with EA Pharma (Japan) | Ulcerative colitis<br>- A locally active steroid -<br>- Rectal foam product - |
| | Ozagrel / KCT-0809 | Kissei / Co-development with Teika (Japan) | Dry-eye with sjögren's syndrome<br>- Restoration of corneal and conjunctival epithelium - |
| | Vibegron / KRP-114V | In-licensed / Co-development with KYORIN Pharmaceutical (Japan) | Overactive bladder<br>- Beta 3 adrenergic receptor agonist - |
| Phase II | KLH-2109 | Kissei | Endometriosis / Uterine fibroids<br>- GnRH antagonist - |
| Phase I / II preparation | YS110 | In-licensed / Y's AC, University of Tokyo, AMED (Japan) | Malignant mesothelioma<br>- Humanized anti-CD26 monoclonal antibody - |
| Phase I | JR-131* | In-licensed / Co-development with JCR Pharmaceuticals (Japan) | Renal anemia<br>- Increase the red blood cell (RBC) count -<br>- A biosimilar "darbepoetin alfa" - |
| | KDT-3594 | Kissei | Parkinson's disease<br>- Dopamine receptor stimulation - |

* Advanced to Phase III in August 2016

### Out-Licensing

| Development Stage | Generic Name / Development Code | Development Company | Territory | Therapeutic Target |
|---|---|---|---|---|
| NDA | Mitiglinide | Eisai (Japan) | ASEAN[1] | Type 2 diabetes mellitus |
| | Silodosin | Eisai (Japan) | ASEAN[2], India[2], Sri Lanka[2] | Dysuria associated with benign prostatic hyperplasia |
| Phase II | Bedoradrine | MediciNova (U.S.) | Worldwide, except for Japan | Acute exacerbation of asthma / Preterm labor |
| | KLH-2109 | ObsEva SA (Switzerland) | Worldwide, except for some Asian countries such as Japan | Endometriosis |
| Phase I | Bedoradrine | MediciNova (U.S.) | Worldwide, except for Japan | COPD |

1: Launched in Thailand, the Philippines, Cambodia, Myanmar; NDA in 2 countries
2: Launched in Thailand, India, Indonesia, the Philippines; Approved in Myanmar, Cambodia ; NDA in 3 ASEAN countries

## Addition of Overactive Bladder Treatment KRP-114V into the Development Pipeline

In March 2016, Kissei concluded a contract with KYORIN Pharmaceutical Co., Ltd. ("Kyorin"), for the collaborative development and marketing of KRP-114V (development code, generic name: vibegron), a drug for the treatment of overactive bladder (OAB), in Japan.

Vibegron is a new chemical entity discovered by Merck Sharp & Dohme and is expected to be a once-a-day OAB medication with selective beta 3 adrenergic receptor agonist activity. Kyorin introduced the drug through Merck Sharp & Dohme in July 2014 (for which phase II clinical trials had been completed in and outside Japan) and has been carrying out phase III clinical trials.

Under the terms of the contract, Kissei and Kyorin will work together in the continued development of vibegron in Japan. After receiving manufacturing and marketing approval from the regulatory authority, the two companies will also engage in the joint sale of the drug.

Kissei positions urology as one of its strategic fields and, accordingly, has been working to expand its product lineup and improve its presence in this area. The conclusion of this contract is expected to enable the Company to effectively and efficiently advance the development of this OAB treatment as well as maximize efforts to promote its widespread use.

Going forward, Kissei will strive to further contribute to increasing the quality of life of patients with OAB symptoms by promoting the prompt market penetration of vibegron.

# Corporate Governance

## Board of Directors and Board of Corporate Auditors

As of June 29, 2016

(Standing, From Left)
Kando Nakagawa, Hidetoshi Kanai, Minoru Nomura, Shinji Kikuchi, Hiroshi Kusama,
Kenji So, Tetsu Takayama, Eiichi Matsushita, Shigetaka Shimizu, Makoto Yonekubo, Hiroshi Ueno
(Seated, From Left)
Yasuo Takehana, Keiji Fukushima, Hiroe Sato, Mutsuo Kanzawa, Masaki Morozumi, Masayuki Isaji, Yoshio Furihata

**Chairman and CEO**
Mutsuo Kanzawa

**President and COO**
Masaki Morozumi

**Executive Vice President**
Hiroe Sato

**Managing Director**
Masayuki Isaji

**Managing Director**
Keiji Fukushima

**Managing Director**
Yoshio Furihata

**Managing Director**
Yasuo Takehana

**Director**
Kenji So

**Director**
Tetsu Takayama

**Director**
Hiroshi Kusama

**Director**
Eiichi Matsushita

**Director**
Shinji Kikuchi

**Outside Director**
Shigetaka Shimizu

**Outside Director**
Minoru Nomura

**Corporate Auditor**
Makoto Yonekubo

**Corporate Auditor**
Hidetoshi Kanai

**Outside Corporate Auditor**
Hiroshi Ueno

**Outside Corporate Auditor**
Kando Nakagawa

## Our Basic Approach to Corporate Governance

Kissei aims to improve its corporate value and realize sustainable growth as a company with a clear raison d'être. At the same time, the Company positions the enhancement and reinforcement of corporate governance as a core management issue in order to maintain a positive relationship with all of its stakeholders, including shareholders and other investors, customers, local communities, business partners, and employees, as well as to fulfill its social responsibility. As such, the Company established the Kissei Basic Policy on Corporate Governance in October 2015, which represents the Company's basic framework for corporate governance. To improve corporate value, Kissei continuously and periodically revises this policy at Board of Directors' meetings.

### Bodies and Internal Control System

#### Overview of Bodies

Kissei's Board of Directors sets basic strategies for Kissei and makes decisions on all important matters while also providing oversight of business execution. The Board of Directors engages in active debate over operations, with priority on making prompt business decisions and increasing the transparency of operations.

The Company employs a corporate governance management system under which the Board chairman serves as chief executive officer (CEO), given authority over all matters pertaining to management, and the president serves as chief operating officer (COO), responsible for all matters related to business execution. This system delegates certain business execution responsibilities from the Board of Directors, and it was instituted with the aim of strengthening management systems and allowing for management to be conducted more flexibly. In addition, the CEO is responsible for convening meetings of the Board of Managing Directors, which consists of managing directors and directors of a higher rank and is responsible for discussing and ruling on items from a predetermined agenda. Furthermore, the Business Execution Committee has been established as an advisory committee to the COO to aid the COO in decision making and to assist in examining the management matters to be proposed or reported to the Board of Directors.

The Company has adopted a corporate auditor system. This system was deemed rational as the corporate auditors together with the appointed outside directors effectively facilitate improvements in the functionality of the Board of Directors while strengthening management oversight functions. The Company has 2 internal and 2 outside corporate auditors. Corporate auditors attend meetings of the Board of Directors and actively state opinions. One outside corporate auditor is a licensed attorney and the other is a certified public accountant. Consequently, they are able to conduct audits from a specialist perspective.

### Internal Control System and Risk Management Structure

Kissei operates under the management philosophy of "contributing to society through high-quality, innovative pharmaceutical products" and "serving society through our employees." The Kissei Code of Conduct guides employee conduct, with the aim of upholding high ethical standards in R&D, manufacturing, and sales activities, all of which are fundamental to our business as a company involved in life sciences. In addition, Kissei has established the Compliance Committee to provide advice to the Board of Directors to help ensure that all laws and regulations are followed both in letter and spirit. The Company's Compliance Program is conducted on a regular basis, and as part of this program Kissei Pharmaceutical's Compliance Program Manual is continually updated with employees receiving regular instruction on compliance-related issues. In May 2006, Kissei also created the Kissei Basic Policy on Internal Controls, in which every employee is trained. Based on this policy, in addition to maintaining all Company rules, the Risk Management Committee—which is an advisory body to the Board of Directors—was established, and risk management and other internal systems are consequently promoted.

### Internal Audits

Kissei has established the Auditing Department, an independent body that reports directly to the COO. This 4-member body conducts internal audits for each department and all internal systems in Kissei based on the yearly auditing plan, ensuring that all departments are carrying out business activities in an appropriate manner.

The Board of Corporate Auditors and the Auditing Department discuss the auditing systems and auditing plan at the beginning of each fiscal year. In addition, they meet each month to exchange opinions on the status of the audits being conducted.

### Independent Auditor

Kissei regularly undergoes outside auditing by an independent auditor. The independent auditor engages in discussions with members of the Board of Directors, finance officers, and the Board of Corporate Auditors, which aids the strengthening and maintenance of the corporate governance structure. In addition, the Tripartite Auditing Council convenes periodically, providing an opportunity for corporate auditors, Auditing Department staff, and the independent auditor to meet to exchange information and otherwise coordinate with one another.

Furthermore, 2 certified public accountants belonging to Ernst & Young ShinNihon LLC provide the Company with accounting services. As well, 10 certified public accountants and 7 other audit personnel provide assistance in the auditing of the Company.

### Outside Directors and Corporate Auditors

There are no special relationships between the 2 outside directors and 2 outside corporate auditors and the Company that could cause a conflict of interests.

Kissei expects that the outside directors and corporate auditors will participate in management from an objective and neutral standpoint, thereby helping improve the transparency of management.

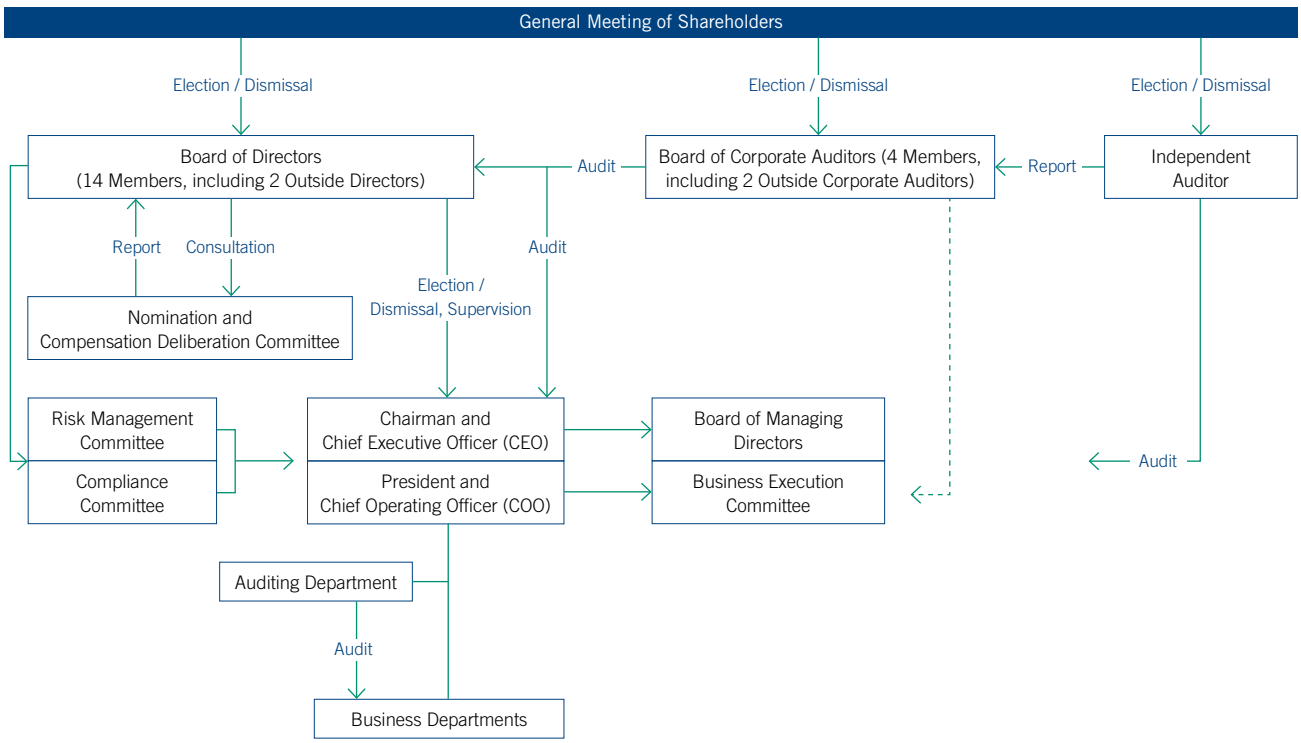
### Reasons for Appointment of Outside Directors

One outside director was selected for his wealth of specialized knowledge gained while working at financial institutions as well as his experience and expertise in corporate management. The other outside director was selected for his in-depth knowledge of corporate management as well as his experience and expertise as a manager at a company that develops businesses primarily related to equipment such as semiconductors and liquid crystals. From a perspective that is independent from business execution, it is anticipated that these outside directors will provide valuable insight and advice to support the Board of Directors in making better decisions with regard to the appropriate management direction and other important matters.

### Reasons for Appointment of Outside Corporate Auditors

One outside corporate auditor has experience as the chairman of an auditing firm and is also versed in finance and accounting due to his experience as a certified public accountant and tax accountant. For this reason, it was judged that this individual possessed substantial insight into corporate management, and was thus selected with the anticipation that he would conduct audits rooted in his insight and years of experience in the

## Corporate Governance Bodies and Internal Control System



fields of finance and accounting. The other outside corporate auditor possesses substantial insight into corporate management from his experience as a licensed attorney practicing in the field of corporate law. This individual was thus selected with the anticipation that he would conduct audits rooted in his legal insight and experience.

### Nomination and Compensation Deliberation Committee

To ensure the independence and objectivity of the Board of Directors' deliberations related to director compensation or the nomination of candidates for director and corporate auditor, as well as enhance the transparency of these processes, the Company established the Nomination and Compensation Deliberation Committee as an advisory body to the Board of Directors. This committee holds meetings where it engages in debate on nominating director and corporate auditor candidates as well as on determining director compensation. In addition, when nominating a candidate for the corporate auditor position, the Company has an outside corporate auditor attend these meetings as a committee member.

### Policies for Determining Director Compensation Amounts and Calculation Methods

Director compensation comprises a base salary and a bonus. Base salary is determined by director rank, and also includes an additional amount based on individual experience.

Bonus is determined by director rank, and takes into account the director's performance for the period.

## Message from Outside Directors

### Outside Director Shigetaka Shimizu

With the full-scale commencement of Japan's Corporate Governance Code, corporate governance is an issue that is garnering a great deal of public attention. While the Code seems to at times overemphasize such aspects as preventing scandals—due to the fact that corporate scandals continue to occur—as well as controlling and avoiding risk from the standpoint of stability, the Code's basic principles aim for the creation of an environment where a company can demonstrate a strong entrepreneurial spirit and exercise the capabilities of its management. As such, I believe that the aim of the Code will lead to growth for corporations, investors, and the economy as a whole.

To realize this growth, however, it is necessary for a company's Board of Directors to lead the reforms amid a constantly changing business environment. In addition, a system that establishes a culture of reform needs to be put into place within a company's organization.

Kissei's Board of Directors has continued to make proactive efforts to reinforce the Company's corporate governance, striving to invigorate its business and improve corporate value while conducting management decisions in a fair and impartial manner.

While emphasizing my independence from the Company as an outside director, I hope to contribute to sound, highly transparent management that can sense changes on its own initiative and lead the way for reform.

### Outside Director Minoru Nomura

The pharmaceutical industry is one that supports economic growth in Japan. However, I understand that the industry is facing an extremely difficult business environment as measures to reduce drug costs continue to move forward against the backdrop of soaring social security costs.

With the changing times, the importance of R&D investments is rising. In order to secure a competitive edge in both domestic and overseas markets, there is a need for prompt decision making and business execution based on risks and benefits.

While I have only been appointed as outside director in June of this year, I believe that Kissei has significant potential to further contribute to society as an R&D-oriented pharmaceutical company. As such, I anticipate the Company will grow in a sustainable manner as an enterprise with a valuable and significant existence that brings joy to the lives of patients through new drugs. To do so, however, I feel that the Company needs to maintain its ambition to take on challenges in drug discovery and remember the importance of emphasizing compliance in its regular business activities.

While offering my independent perspective as an outside director, I hope to leverage my years of experience as a corporate manager and the knowledge I have acquired through participating in the management of international companies in order to contribute to the critical management decisions of the Company.

# Corporate Social Responsibility

Guided by the management philosophy of "contributing to society through high-quality, innovative pharmaceutical products" and "serving society through our employees," which has been in place since its founding, Kissei is promoting a wide range of CSR initiatives.

## Compliance Initiatives

All our employees are expected to act in accordance with social norms and corporate ethics. Kissei believes this type of appropriate action enhances its brand and corporate image and also helps improve both corporate value and the trust stakeholders hold in the Company.

Kissei has formulated the Kissei Code of Conduct and published Kissei Pharmaceutical's Compliance Program Manual based on the basic principles for employee behavior as members of society. This Code and Manual are used as guidelines for employees in practicing compliance. Kissei also thoroughly reinforces the importance of adhering to corporate ethics with all employees through compliance education and training that is carried out in line with annual plans. Furthermore, the Company has established an employee helpline that functions as an additional contact and consultation system for compliance issues, such as compliance violations, sexual harassment, misuses of power, and general compliance-related consultations.

After having undergone inspections by the third-party organization Japan Health Sciences Foundation, the Central Research Laboratories and Pharmacokinetics Laboratories have been certified as an organization that conducts humane animal testing, appropriately breeding, protecting, and caring for test animals. Furthermore, in March 2015, the Toxicological Laboratories, a safety research facility, received full accreditation from the Association for Assessment and Accreditation of Laboratory Animal Care International (AAALAC International), indicating that this facility is operating at a level that meets international standards for humane animal testing.

Certificate from Japan Health Sciences Foundation

Certificate from AAALAC International

## Involvement in Society

We value the connection we have with local communities. As such, we continue to actively make social contributions in areas such as local culture, medical treatment, health, welfare, environment, and sports.

### Contribution to Medical Treatment and Health

#### Management of the Kanzawa Medical Research Foundation

In June 1997, we established the Kanzawa Medical Research Foundation to commemorate the 50th year since our founding. With the purpose of advancing healthcare and medical science and contributing to the health and welfare of people in Japan, the Foundation assists and rewards diversified research related to various diseases that occur in women of reproductive age, with a focus on the perinatal period, as well as diseases that occur in elderly and senile women. The Foundation also holds events such as lectures related to this research.

**Number of Cases Supported and Total Amount of Funds Granted Over the Period of 19 Years (1997–2015)**

| | Number of Cases | Total Amount |
|---|---|---|
| Kanzawa Medical Award | 17 | ¥50 million |
| Research Grants | 187 | ¥197 million |
| Overseas Study Grants | 70 | ¥35 million |


Lecture by Kanzawa Medical Award recipient

### Contributions to Welfare

#### Donations to a Children's Welfare Center

As part of our local social contribution activities, we have been raising funds and carrying out charity bazaars at Company cultural festivals held at our headquarters, the Matsumoto Plant, and the area surrounding Shiojiri City. The proceeds raised from these activities are donated to Matsumoto Children's Park, a welfare center for children.

### Contributions to Culture and the Arts

#### Support of the Seiji Ozawa Matsumoto Festival

We believe that supporting and developing cultural activities that bring people together and touch them emotionally are an important corporate role. Accordingly, we have been supporting the Seiji Ozawa Matsumoto Festival (formerly Saito Kinen Festival Matsumoto), an international music festival held in fall every year in Matsumoto City, since the first year it was held in 1992.

Concert by the Saito Kinen Orchestra © michiharu okubo

## Involvement with Customers

### Product Customer Service Center

We established the Product Customer Service Center to respond to inquiries from doctors, pharmacists, and other healthcare professionals, as well as from patients and their families. Responding to such inquiries helps provide our customers with important drug-related information and promotes proper drug use, thereby enhancing a drug's usefulness. Communication with our customers in an accurate, prompt, and polite manner works to fulfill the important role of increasing customer satisfaction and improving the level of trust customers have toward our products and the Company itself. The opinions we receive from customers are shared internally and used to make improvements to our products.

### Disclosure of Basic Drug Information Online

The Product Customer Service Center provides drug-related information for medical personnel through its website, which in turn allows the latest information to be easily accessed. In addition to basic information, such as drug package inserts and pictures of pharmaceutical formulations, the website contains more in-depth information, including notifications of revisions to drug package inserts and outlines of educational seminars. Aiming for a website where important information can be accessed easily, we added a product Q&A section to the website that handles frequently asked questions related to our products.

## Involvement with Employees

### Workplace Health and Safety

To establish a workplace environment that secures employee safety, peace of mind, and trust, we are engaging in health and safety activities lead primarily by our Environment, Health and Safety Committee. These activities include educational training for new employees, workplace safety education, regular workplace inspections, and the placement of informative posters throughout the workplace to raise employee awareness toward safety. In addition to installing automated external defibrillators (AED) at all of our offices, we are implementing standard first aid training courses for employees.

While 3 workplace accidents occurred in fiscal 2015, none of these accidents were serious.

### Initiatives to Develop the Next Generation

Through the creation of a friendly workplace environment that allows employees to realize a balance between their work life and family life, we are working to establish employment conditions in which all employees can sufficiently exercise their abilities.

In recognition of our efforts, we were awarded certification as a standards-compliant general business owner (Kurumin) in 2008, 2011, and 2015, in accordance with the Next Generation Education and Support Promotion Act. Furthermore, we are working to realize a work-life balance for all employees based on our newly established action plan.

Next-Generation certification mark (Kurumin)

## Involvement in the Environment

Our basic environmental policy is based on the following fundamental Company goal: As a drug discovery and R&D-oriented company that aims to ensure the future health of people around the world, we will actively work to preserve the environment as part of our corporate social responsibilities and contribute to realizing an affluent and comfortable society. In accordance with this basic environmental policy, we strive to minimize the adverse impact of all our activities on the environment and to contribute to environmental protection.

### Chemical Substances

At all of our laboratories, we make concerted efforts to use and manage chemical substances in an appropriate manner. We have introduced systems that can manage chemical reagents used in our laboratories in a uniform manner, from purchase to storage and disposal. In this way, we aim to reduce the amount of chemical substances we store at our facilities.

# Financial Review

## Financial Position

At the end of the fiscal year under review, ended March 31, 2016, total assets stood at ¥193,346 million, up ¥11,861 million from the previous fiscal year-end. Total current assets rose ¥2,689 million, to ¥100,051 million, due to an increase in inventories and notes and accounts receivable, which offset a decrease in cash on hand and in banks as well as marketable securities. Total non-current assets were up ¥9,172 million, to ¥93,295 million, reflecting an increase in investments in securities.

Total liabilities amounted to ¥35,221 million at the fiscal year-end, up ¥4,456 million from the previous fiscal year-end. Total current liabilities stood at ¥19,608 million, up ¥673 million, due to an increase in payables and advances included in other current liabilities as well as income taxes payable. Total long-term liabilities were up ¥3,783 million, to ¥15,613 million, due to a rise in net defined benefit liability.

Total net assets amounted to ¥158,125 million at the fiscal year-end, an increase of ¥7,405 million compared with the previous fiscal year-end. This increase reflected a rise in unrealized holding gains on securities and retained earnings, in addition to fluctuations following the cancellation of treasury stock.

As a result, the shareholders' equity ratio was 81.6%, down from 82.9% at the previous fiscal year-end.

## Financial Results

Overall net sales increased 1.7% year on year, to ¥71,294 million. Accounting for the majority of net sales, the segment sales of the Kissei Group's core pharmaceutical business were up ¥2,128 million, or 3.6%, to ¥61,822 million. In this segment, sales of Urief®, Glubes® combination tablet, Glufast®, and Epoetin Alfa BS Injection [JCR] increased as did revenue from technical fees and supply to domestic business partners. In other business segments, sales decreased ¥945 million, or 9.1%, to ¥9,472 million. This decrease was attributable to the decline in revenues from merchandising and construction industries, which offset a rise in revenue from information services.

In the pharmaceutical business, the cost of sales ratio was down 0.1 percentage point due to changes in sales composition and the lack of significant change in the cost of sales ratio for individual products. In other businesses, the cost of sales ratio fell 3.0 percentage points, resulting from changes in the sales composition of construction industries, where the cost of sales ratio is high. Due to these factors, gross profit rose ¥1,669 million, or 3.6%, to ¥47,714 million.

In selling, general and administrative expenses, while selling expenses increased, general and administrative expenses and R&D expenses decreased. As a result, operating income rose ¥1,940 million, or 23.3%, to ¥10,274 million.

In other income (expenses), gain on valuation of securities declined, and the Company recorded a foreign exchange loss and impairment loss. As a result, the net of other income (expenses) resulted in net other income of ¥863 million, down ¥1,270 million.

As a result of the above, profit before income taxes and non-controlling interests was up ¥671 million, or 6.4%, to ¥11,137 million, and profit attributable to owners of parent rose ¥1,000 million, or 14.0%, to ¥8,165 million.

## Basic Policy on the Distribution of Profits / Dividends for the Fiscal Year under Review and the Current Fiscal Year

Kissei aims to secure a solid management base while providing stable, consistent returns to shareholders through cash dividends. Kissei considers working to make efficient use of capital while paying fair dividends to shareholders in accordance with profit levels to be a key management issue.

Kissei's basic dividend policy is to make twice-yearly dividend payments, comprised of interim and year-end cash dividends. The Board of Directors decides the amount of the interim cash dividend, while the General Meeting of Shareholders decides the amount of the year-end cash dividend. Also, Kissei's articles of incorporation stipulate that a resolution of the Board of Directors enables the payment of interim cash dividends with a date of record of September 30 each year.

Giving first priority to increasing shareholder value, Kissei will acquire and dispose of treasury stock, based on resolutions of the Board of Directors, flexibly and as necessary in light of operational developments.

Internal funds are maintained to respond to expected changes in government policy, system reforms, and the challenges of increasing globalization. At the same time, Kissei will actively invest in R&D to develop drugs that patients need. Kissei believes this policy will not only contribute to future profits but also enable Kissei to distribute profits to its shareholders appropriately.

For the fiscal year under review, Kissei paid a year-end cash dividend of ¥22.0 per share, which when combined with an interim cash dividend of ¥22.0 per share gave a full-year cash dividend of ¥44.0 per share.

For the current fiscal year, ending March 31, 2017, the Group plans to pay an interim cash dividend of ¥23.0 per share and a year-end cash dividend of ¥23.0 per share, giving a full-year cash dividend of ¥46.0 per share.

# Risk Factors

The following risk factors could potentially affect the Kissei Group's operating results and financial position. Forward-looking statements are based on the judgments the Kissei Group has made from the consolidated financial statements for the end of the fiscal year under review.

## 1 R&D

The process of developing pharmaceuticals—from the R&D stage to approval and sales—requires large investments of both time and funds. When developing new drugs, the chances of discovering beneficial indications are limited. In addition, Kissei can guarantee neither that a new drug undergoing development or an additional indication will have its intended benefit nor predict when or if the drug will be approved.

## 2 Government Policy

The prices of pharmaceuticals in Japan are set based on the government's NHI drug prices. Generally, the prices are revised biennially. There may be revisions or other changes to the medical insurance system in Japan that go beyond Kissei's assumptions, such as the introduction of diagnosis procedure combinations or the promotion of generic drugs, which would negatively impact Kissei's operating results and financial position.

## 3 Competition with Other Companies' Products

The Kissei Group faces competition from companies selling products with the same application as its own. In addition, once a patent expires, price competition with generic products of the same composition intensifies. This competition could have a serious impact on the sales of existing drugs.

## 4 Unexpected Side-Effect Risks

There is a risk that a pharmaceutical may produce an unexpected side effect that was undiscovered at the R&D stage. If unforeseen side effects or serious adverse events occur, the use of a drug may be limited, or sales of the drug may be terminated completely.

## 5 Manufacturing and Procurement

Malfunctions with production equipment or the inability to procure raw materials in a timely fashion could delay or shut down drug manufacturing. In addition, a quality problem may cause a drug to be recalled, which would negatively impact Kissei's operating results and financial position.

## 6 Intellectual Property Risks

In the event that the Kissei Group is unable to appropriately protect its intellectual property, a third party may be able to use the Kissei Group's technology, which would undermine its competitive superiority in the market.

## 7 Legal Risks

At present, there are no outstanding legal problems affecting the Kissei Group's management. There is the possibility, however, that in the course of its business activities, the Kissei Group could face lawsuits in the future both at home and abroad regarding patent, product liability, environment, and labor matters.

## 8 Environmental Conservation

Pharmaceutical chemical substances used in research and manufacturing processing could have an impact on the environment. Every department and work site in the Kissei Group is working diligently to follow stringent substance management rules to protect the environment. However, if chemical substances were found to have polluted areas around a work site, legal action may be taken against the work site, and Kissei may be faced with large costs to restore the environment, which would negatively impact Kissei's operating results and financial position.

## 9 Information Management

The Kissei Group is paying close attention to the need to protect information by establishing strict rules for the management of personal and confidential information as well as providing education on this issue to employees. However, if an unexpected incident occurred in which information was improperly disclosed, the Kissei Group's image may be tarnished, which could negatively impact Kissei's operating results and financial position.

Besides the risk factors mentioned above, there are various other risks faced by the Kissei Group.

# Consolidated Balance Sheets

Kissei Pharmaceutical Co., Ltd. and its subsidiaries
At March 31, 2015 and 2016

| | Millions of yen | | Thousands of U.S. dollars (Note 3) |
|---|---|---|---|
| **Assets** | **2016** | 2015 | **2016** |
| **Current Assets:** | | | |
| Cash on hand and in banks (Notes 4 and 5) | **¥ 25,666** | ¥ 27,242 | **$ 227,133** |
| Notes and accounts receivable (Note 5) | **24,967** | 23,676 | **220,947** |
| Marketable securities (Notes 4, 5 and 6) | **24,476** | 25,132 | **216,602** |
| Inventories (Note 7) | **17,376** | 14,646 | **153,770** |
| Deferred tax assets—current (Note 9) | **2,038** | 2,019 | **18,035** |
| Other current assets | **5,529** | 4,648 | **48,929** |
| Allowance for doubtful accounts | **(1)** | (1) | **(9)** |
| Total current assets | **100,051** | 97,362 | **885,407** |
| **Property, Plant and Equipment:** | | | |
| Buildings and structures (Note 13) | **37,830** | 37,696 | **334,779** |
| Less: accumulated depreciation | **(26,780)** | (26,368) | **(236,991)** |
| Buildings and structures, net | **11,050** | 11,328 | **97,788** |
| Land (Note 13) | **12,984** | 13,056 | **114,903** |
| Construction in progress | **—** | 50 | **—** |
| Other | **14,696** | 14,414 | **130,054** |
| Less: accumulated depreciation | **(11,971)** | (11,995) | **(105,939)** |
| Other, net | **2,725** | 2,419 | **24,115** |
| Total property, plant and equipment | **26,759** | 26,853 | **236,806** |
| **Intangible Assets:** | | | |
| Software for internal use | **775** | 744 | **6,858** |
| Other | **38** | 42 | **337** |
| Total intangible assets | **813** | 786 | **7,195** |
| **Investments and Other Assets:** | | | |
| Investments in securities (Notes 5 and 6) | **62,301** | 54,382 | **551,336** |
| Long-term loans receivable | **115** | 135 | **1,018** |
| Long-term prepaid expenses | **1,691** | 490 | **14,965** |
| Deferred tax assets—non-current (Note 9) | **553** | 432 | **4,894** |
| Other | **1,116** | 1,098 | **9,875** |
| Allowance for doubtful accounts | **(53)** | (53) | **(469)** |
| Total investments and other assets | **65,723** | 56,484 | **581,619** |
| Total assets | **¥193,346** | ¥181,485 | **$1,711,027** |

The accompanying notes are an integral part of these statements.

| Liabilities and Net Assets | Millions of yen 2016 | 2015 | Thousands of U.S. dollars (Note 3) 2016 |
|---|---|---|---|
| **Current Liabilities:** | | | |
| Notes and accounts payable | **¥ 5,830** | ¥ 6,046 | **$ 51,593** |
| Short-term bank loans (Note 8) | **1,730** | 1,730 | **15,310** |
| Current portion of long-term debt (Note 8) | **85** | 85 | **752** |
| Income taxes payable (Note 9) | **1,669** | 1,372 | **14,770** |
| Accrued bonuses to employees | **2,185** | 2,144 | **19,336** |
| Accrued bonuses to directors and corporate auditors | **25** | 25 | **221** |
| Reserve for sales returns | **13** | 15 | **115** |
| Reserve for sales rebates | **377** | 337 | **3,336** |
| Reserve for sales promotion expenses | **195** | 174 | **1,726** |
| Other current liabilities | **7,499** | 7,007 | **66,363** |
| Total current liabilities | **19,608** | 18,935 | **173,522** |
| **Long-Term Liabilities:** | | | |
| Long-term debt (Note 8) | **1,489** | 1,464 | **13,177** |
| Deferred tax liabilities—non-current (Note 9) | **7,395** | 7,338 | **65,442** |
| Net defined benefit liability (Note 10) | **6,014** | 2,279 | **53,221** |
| Accrued retirement benefits to directors and corporate auditors | **127** | 114 | **1,124** |
| Asset retirement obligations | **110** | 108 | **973** |
| Other long-term liabilities | **478** | 527 | **4,231** |
| Total long-term liabilities | **15,613** | 11,830 | **138,168** |
| Total liabilities | **35,221** | 30,765 | **311,690** |
| **Contingent Liabilities** (Note 12) | | | |
| **Net Assets:** | | | |
| Shareholders' equity: | | | |
| Common stock: | | | |
| Authorized: 227,000,000 shares | | | |
| Issued: 56,911,185 shares and 54,311,185 shares at March 31, 2015 and 2016, respectively | **24,357** | 24,357 | **215,549** |
| Additional paid-in capital | **24,247** | 24,254 | **214,575** |
| Retained earnings | **96,231** | 95,566 | **851,602** |
| Treasury stock (7,982,957 shares and 5,383,634 shares at March 31, 2015 and 2016, respectively) | **(11,190)** | (16,592) | **(99,027)** |
| Total shareholders' equity | **133,645** | 127,585 | **1,182,699** |
| Accumulated other comprehensive income: | | | |
| Unrealized holding gains on securities | **25,945** | 21,518 | **229,602** |
| Retirement benefits liability adjustments | **(1,730)** | 1,338 | **(15,310)** |
| Total accumulated other comprehensive income | **24,215** | 22,856 | **214,292** |
| Non-controlling interests | **265** | 279 | **2,346** |
| Total net assets | **158,125** | 150,720 | **1,399,337** |
| Total liabilities and net assets | **¥193,346** | ¥181,485 | **$1,711,027** |

# Consolidated Statements of Income and Consolidated Statements of Comprehensive Income

Kissei Pharmaceutical Co., Ltd. and its subsidiaries
For the years ended March 31, 2015 and 2016

## Consolidated Statements of Income

| | Millions of yen | | Thousands of U.S. dollars (Note 3) |
|---|---|---|---|
| | **2016** | 2015 | **2016** |
| **Net Sales** | **¥71,294** | ¥70,111 | **$630,920** |
| **Cost of Sales** | **23,580** | 24,066 | **208,672** |
| Gross profit | **47,714** | 46,045 | **422,248** |
| **Selling, General and Administrative Expenses** (Note 16) | **37,440** | 37,711 | **331,327** |
| Operating income | **10,274** | 8,334 | **90,921** |
| **Other Income (Expenses):** | | | |
| Interest and dividend income | **990** | 893 | **8,761** |
| Interest expense | **(31)** | (33) | **(274)** |
| Gain on sales of investment securities | **0** | 7 | **0** |
| Loss on sales or disposal of properties | **(28)** | (115) | **(248)** |
| Income (loss) from investments in partnerships | **(40)** | 58 | **(354)** |
| Gain on sales of property, plant and equipment | **1** | 11 | **9** |
| Gain on valuation of securities | **132** | 729 | **1,168** |
| Impairment loss | **(108)** | — | **(956)** |
| Foreign exchange gain (loss) | **(41)** | 486 | **(363)** |
| Loss on valuation of stocks of subsidiaries and affiliates | **(60)** | — | **(531)** |
| Loss on valuation of investments in capital of subsidiaries and affiliates | **(22)** | (22) | **(195)** |
| Other, net | **70** | 118 | **620** |
| Total other income (expenses) | **863** | 2,132 | **7,637** |
| Profit before income taxes and non-controlling interests | **11,137** | 10,466 | **98,558** |
| **Income Taxes** (Note 9)**:** | | | |
| Current | **2,970** | 3,408 | **26,283** |
| Deferred | **(29)** | (131) | **(256)** |
| | **2,941** | 3,277 | **26,027** |
| **Profit** | **8,196** | 7,189 | **72,531** |
| **Profit Attributable to Non-Controlling Interests** | **31** | 24 | **274** |
| **Profit Attributable to Owners of Parent** | **¥ 8,165** | ¥ 7,165 | **$ 72,257** |

| | Yen | | U.S. dollars (Note 3) |
|---|---|---|---|
| **Per Share:** | | | |
| Profit attributable to owners of parent: | | | |
| Primary | **¥166.89** | ¥142.14 | **$1.477** |
| Fully diluted | **—** | — | **—** |
| Cash dividends | **44.0** | 42.0 | **0.389** |

The accompanying notes are an integral part of these statements.

## Consolidated Statements of Comprehensive Income

| | Millions of yen | | Thousands of U.S. dollars (Note 3) |
|---|---|---|---|
| | **2016** | 2015 | **2016** |
| **Profit** | **¥ 8,196** | ¥ 7,189 | **$ 72,531** |
| **Other Comprehensive Income:** | | | |
| Unrealized holding gains on securities | **4,427** | 8,794 | **39,177** |
| Retirement benefits liability adjustments | **(3,112)** | 2,345 | **(27,540)** |
| Total other comprehensive income (Note 11) | **1,315** | 11,139 | **11,637** |
| **Comprehensive Income** | **¥ 9,511** | ¥18,328 | **$ 84,168** |
| Comprehensive income attributable to: | | | |
| Shareholders of Kissei Pharmaceutical Co., Ltd. | **¥ 9,525** | ¥18,275 | **$ 84,292** |
| Non-controlling interests | **(14)** | 53 | **(124)** |

The accompanying notes are an integral part of these statements.

# Consolidated Statements of Changes in Net Assets

Kissei Pharmaceutical Co., Ltd. and its subsidiaries
For the years ended March 31, 2015 and 2016

| | Millions of yen | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Shareholders' equity | | | | Accumulated other comprehensive income | | | |
| | Number of shares of common stock | Common stock | Additional paid-in capital | Retained earnings | Treasury stock | Unrealized holding gains on securities | Retirement benefits liability adjustments | Non-controlling interests | Total net assets |
| **Balance at April 1, 2014** | 56,911,185 | ¥24,357 | ¥24,254 | ¥90,918 | ¥ (8,685) | ¥12,724 | ¥ (978) | ¥231 | ¥142,821 |
| Cumulative effects of change in accounting policy | — | — | — | (407) | — | — | — | (5) | (412) |
| Restated balance at April 1, 2014 | 56,911,185 | 24,357 | 24,254 | 90,511 | (8,685) | 12,724 | (978) | 226 | 142,409 |
| Profit attributable to owners of parent for the year | — | — | — | 7,165 | — | — | — | — | 7,165 |
| Cash dividends paid | — | — | — | (2,110) | — | — | — | — | (2,110) |
| Treasury stock purchased (2,542,418 shares) | — | — | — | — | (7,907) | — | — | — | (7,907) |
| Unrealized holding gains on securities | — | — | — | — | — | 8,794 | — | — | 8,794 |
| Retirement benefits liability adjustments | — | — | — | — | — | — | 2,316 | — | 2,316 |
| Gain on sales of treasury stock (64 shares) | — | — | 0 | — | 0 | — | — | — | 0 |
| Net changes in items other than those in shareholders' equity | — | — | — | — | — | — | — | 53 | 53 |
| **Balance at April 1, 2015** | 56,911,185 | ¥24,357 | ¥24,254 | ¥95,566 | ¥(16,592) | ¥21,518 | ¥1,338 | ¥279 | ¥150,720 |
| Profit attributable to owners of parent for the year | **—** | **—** | **—** | **8,165** | **—** | **—** | **—** | **—** | **8,165** |
| Cash dividends paid | **—** | **—** | **—** | **(2,104)** | **—** | **—** | **—** | **—** | **(2,104)** |
| Treasury stock purchased (711 shares) | **—** | **—** | **—** | **—** | **(2)** | **—** | **—** | **—** | **(2)** |
| Unrealized holding gains on securities | **—** | **—** | **—** | **—** | **—** | **4,427** | **—** | **—** | **4,427** |
| Retirement benefits liability adjustments | **—** | **—** | **—** | **—** | **—** | **—** | **(3,068)** | **—** | **(3,068)** |
| Gain on sales of treasury stock (34 shares) | **—** | **—** | **—** | **—** | **1** | **—** | **—** | **—** | **1** |
| Cancellation of treasury stock (2,600,000 shares) | **(2,600,000)** | **—** | **(7)** | **(5,396)** | **5,403** | **—** | **—** | **—** | **—** |
| Net changes in items other than those in shareholders' equity | **—** | **—** | **—** | **—** | **—** | **—** | **—** | **(14)** | **(14)** |
| **Balance at March 31, 2016** | **54,311,185** | **¥24,357** | **¥24,247** | **¥96,231** | **¥(11,190)** | **¥25,945** | **¥(1,730)** | **¥265** | **¥158,125** |

| | Thousands of U.S. dollars (Note 3) | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|
| | | Shareholders' equity | | | | Accumulated other comprehensive income | | | |
| | Number of shares of common stock | Common stock | Additional paid-in capital | Retained earnings | Treasury stock | Unrealized holding gains on securities | Retirement benefits liability adjustments | Non-controlling interests | Total net assets |
| **Balance at April 1, 2015** | 56,911,185 | $215,549 | $214,637 | $845,717 | $(146,832) | $190,425 | $ 11,840 | $2,469 | $1,333,805 |
| Profit attributable to owners of parent for the year | **—** | **—** | **—** | **72,257** | **—** | **—** | **—** | **—** | **72,257** |
| Cash dividends paid | **—** | **—** | **—** | **(18,620)** | **—** | **—** | **—** | **—** | **(18,620)** |
| Treasury stock purchased (711 shares) | **—** | **—** | **—** | **—** | **(18)** | **—** | **—** | **—** | **(18)** |
| Unrealized holding gains on securities | **—** | **—** | **—** | **—** | **—** | **39,177** | **—** | **—** | **39,177** |
| Retirement benefits liability adjustments | **—** | **—** | **—** | **—** | **—** | **—** | **(27,150)** | **—** | **(27,150)** |
| Gain on sales of treasury stock (34 shares) | **—** | **—** | **—** | **—** | **9** | **—** | **—** | **—** | **9** |
| Cancellation of treasury stock (2,600,000 shares) | **(2,600,000)** | **—** | **(62)** | **(47,752)** | **47,814** | **—** | **—** | **—** | **—** |
| Net changes in items other than those in shareholders' equity | **—** | **—** | **—** | **—** | **—** | **—** | **—** | **(123)** | **(123)** |
| **Balance at March 31, 2016** | **54,311,185** | **$215,549** | **$214,575** | **$851,602** | **$ (99,027)** | **$229,602** | **$(15,310)** | **$2,346** | **$1,399,337** |

The accompanying notes are an integral part of these statements.

# Consolidated Statements of Cash Flows

Kissei Pharmaceutical Co., Ltd. and its subsidiaries
For the years ended March 31, 2015 and 2016

| | Millions of yen | | Thousands of U.S. dollars (Note 3) |
|---|---|---|---|
| | **2016** | 2015 | **2016** |
| **Cash Flows from Operating Activities:** | | | |
| Profit before income taxes and non-controlling interests | **¥11,137** | ¥ 10,466 | **$ 98,558** |
| Depreciation and amortization | **2,344** | 2,204 | **20,743** |
| Increase (decrease) in allowance reserves | **113** | (502) | **1,000** |
| Decrease in net defined benefit liability | **(790)** | (626) | **(6,991)** |
| Impairment loss | **108** | — | **956** |
| Interest and dividend income | **(990)** | (893) | **(8,761)** |
| Interest expense | **31** | 33 | **274** |
| Foreign exchange (gain) loss | **(21)** | (460) | **(186)** |
| Gain on valuation of securities | **(132)** | (729) | **(1,168)** |
| Gain on sales of property, plant and equipment | **(1)** | (11) | **(9)** |
| Loss (gain) on sales of investment securities | **(0)** | (7) | **(0)** |
| Loss on sales or disposal of properties | **28** | 115 | **248** |
| (Increase) decrease in notes and accounts receivable | **(1,291)** | 36 | **(11,425)** |
| (Increase) decrease in inventories | **(2,730)** | (1,833) | **(24,159)** |
| (Increase) decrease in other current assets | **(733)** | (214) | **(6,487)** |
| Increase (decrease) in notes and accounts payable | **(216)** | 656 | **(1,912)** |
| Increase (decrease) in other current liabilities | **872** | 3,162 | **7,717** |
| Increase (decrease) in other long-term liabilities | **(0)** | (83) | **(0)** |
| Loss on valuation of stocks of subsidiaries and affiliates | **60** | — | **531** |
| Loss on valuation of investments in capital of subsidiaries and affiliates | **22** | 22 | **195** |
| Other | **49** | (17) | **433** |
| Sub total | **7,860** | 11,319 | **69,557** |
| Receipt of interest and dividends | **923** | 833 | **8,168** |
| Payment of interest | **(31)** | (34) | **(274)** |
| Payment of income taxes | **(2,989)** | (5,451) | **(26,451)** |
| Net cash provided by operating activities | **5,763** | 6,667 | **51,000** |
| **Cash Flows from Investing Activities:** | | | |
| Time deposits received | **85** | 75 | **752** |
| Time deposits paid | **(83)** | (75) | **(735)** |
| Reduction of investments in specified trusts | **49** | 47 | **434** |
| Proceeds from sales of marketable securities | **100** | — | **885** |
| Acquisition of property and equipment | **(1,979)** | (1,975) | **(17,513)** |
| Proceeds from sales of property and equipment | **1** | 40 | **9** |
| Acquisition of intangible assets | **(303)** | (391) | **(2,681)** |
| Acquisition of investments in securities | **(2,690)** | (2,030) | **(23,805)** |
| Proceeds from sales of investments in securities | **538** | 1,114 | **4,761** |
| Payments for loans | **(93)** | (113) | **(823)** |
| Collection of loans | **114** | 120 | **1,009** |
| Long-term advance payment costs | **(1,358)** | (6) | **(12,018)** |
| Other | **(66)** | 25 | **(585)** |
| Net cash used in investing activities | **(5,685)** | (3,169) | **(50,310)** |
| **Cash Flows from Financing Activities:** | | | |
| Short-term bank debt received | **100** | — | **885** |
| Repayment of short-term bank debt | **(100)** | (30) | **(885)** |
| Long-term debt received | **110** | 200 | **973** |
| Repayment of long-term debt | **(85)** | (172) | **(752)** |
| Repayment of finance lease obligation | **(65)** | (63) | **(575)** |
| Cash dividends paid | **(2,104)** | (2,110) | **(18,619)** |
| Treasury stock purchased | **(2)** | (7,907) | **(18)** |
| Treasury stock sale | **0** | 0 | **0** |
| Net cash used in financing activities | **(2,146)** | (10,082) | **(18,991)** |
| **Effect of Exchange Rate Changes on Cash and Cash Equivalents** | **21** | 461 | **186** |
| **Increase (Decrease) in Cash and Cash Equivalents** | **(2,047)** | (6,123) | **(18,115)** |
| **Cash and Cash Equivalents at Beginning of Year** (Note 4) | **52,142** | 58,265 | **461,434** |
| **Cash and Cash Equivalents at End of Year** (Note 4) | **¥50,095** | ¥ 52,142 | **$443,319** |

The accompanying notes are an integral part of these statements.

# Notes to the Consolidated Financial Statements

Kissei Pharmaceutical Co., Ltd. and its subsidiaries

## Note 01 Basis of Presenting the Consolidated Financial Statements

The accompanying consolidated financial statements of Kissei Pharmaceutical Co., Ltd. (the Company) and its subsidiaries (the Companies) are prepared on the basis of accounting principles generally accepted in Japan, which are different in certain respects as to application and disclosure requirements of International Financial Reporting Standards, and are compiled from the consolidated financial statements prepared by the Company as required by the Financial Instruments and Exchange Act of Japan.

## Note 02 Summary of Significant Accounting Policies

### (1) Scope of Consolidation

The numbers of subsidiaries the Company had for the years ended March 31, 2015 and 2016 were six, respectively, of which three were consolidated in the respective years. The subsidiaries that have been consolidated with the Company are listed below:

| Name of subsidiaries | % of voting rights owned | Paid-in capital, millions of yen |
|---|---|---|
| Kissei Shoji Co., Ltd. | **100%** | **¥ 50** |
| Kissei Comtec Co., Ltd. | **84%** | **¥334** |
| Hashiba Technos Co., Ltd. | **100%** | **¥ 45** |

### (2) Consolidation and Elimination

In preparing the accompanying consolidated financial statements, all significant intercompany transactions, account balances, and unrealized profits between the Companies have been eliminated, and the portion thereof attributable to non-controlling interests is charged to non-controlling interests.

In eliminating investments in the common stock of the consolidated subsidiaries against the underlying equity in the net assets of the subsidiaries, differences between the cost of the investments and the underlying equity in net assets were not recognized for the two years ended March 31, 2016.

### (3) Investments in Unconsolidated Subsidiaries

Investments in unconsolidated subsidiaries are carried at cost, cost being determined by the moving average method, as there would be no significant effect in the consolidated statements of income if they were accounted for by the equity method.

### (4) Valuation of Securities

Held-to-maturity debt securities are carried at amortized cost.

Marketable securities classified as other securities are carried at fair value as of the balance sheet date with changes in unrealized holding gain or loss, net of the applicable income taxes, included directly in net assets. The cost of securities sold is primarily determined by the moving average method.

Non-marketable securities classified as other securities are stated at cost primarily determined by the moving average method.

Short-term investments in specified trusts are stated at market value.

### (5) Inventory Valuation

Inventories are mainly valued at cost using the gross average method (the amount on the balance sheet is reduced to reflect decreased profitability).

### (6) Method of Depreciation of Significant Depreciable Assets

(i) Property, plant and equipment (excluding lease assets)

Depreciation is computed on the declining-balance method at rates based on the estimated useful lives of the assets. The range of useful lives is principally from 3 to 50 years for buildings and structures.

Depreciation for buildings (excluding leasehold improvements and auxiliary facilities attached to buildings) acquired on or after April 1, 1998 is computed on the straight-line method.

(ii) Intangible assets (excluding lease assets)

Depreciation is computed on the straight-line method.

Software costs for internal use are amortized over their expected useful lives (mainly 5 years) on a straight-line basis.

(iii) Lease assets

Lease assets are depreciated by the straight-line method with the respective lease period and the residual value being zero.

### (7) Accounting for Consumption Tax

Consumption tax is imposed at the flat rate of 8% on all domestic consumption of goods and services (with certain exemptions).

Consumption tax withheld upon sale and consumption tax paid by the Companies on their purchases of goods and services are not included in the respective revenue and cost or expenses in the accompanying consolidated statements of income.

### (8) Foreign Currency Translation

Receivables and payables denominated in foreign currencies are translated into yen at the rates of exchange in effect at the balance sheet date, and differences arising from the translation are included in the consolidated statement of income.

Investments in unconsolidated subsidiaries denominated in foreign currencies are translated at the historical exchange rates prevailing at the time such transactions were made.

### (9) Income Taxes

Income taxes of the Companies consist of corporate income tax, local inhabitants taxes and enterprise tax.

The asset and liability approach is used to recognize deferred tax assets and liabilities in respect of temporary differences between the carrying amounts and the basis of assets and liabilities.

### (10) Allowances, Accrued Bonuses to Employees and Reserves for Certain Expenses

(i) Allowance for doubtful accounts

The Companies provide an “Allowance for doubtful accounts” based on the percentage of their historical bad debt loss incurred against the balance of total receivables in addition to the amount of uncollectable receivables estimated on an individual basis.

(ii) Accrued bonuses to employees

“Accrued bonuses to employees” is provided for based on estimated amounts which the Companies should pay to employees for their services rendered during the six-month period ended on the balance sheet date.

(iii) Accrued bonuses to directors and corporate auditors

“Accrued bonuses to directors and corporate auditors” is provided for based on estimated payments for their performance during the year ended March 31.

(iv) Reserve for sales returns
"Reserve for sales returns" is estimated based on the percentage of the Companies' own actual return history against sales.
(v) Reserve for sales rebates
"Reserve for sales rebates" is provided for in an amount equivalent to the expected amount payable by the Companies to dealers in respect of the balance of accounts receivable at the balance sheet date based on current applicable rebate rates.

**(11) Accounting Method for Retirement Benefits**
Accrued retirement benefits and prepaid pension cost for employees have been recorded mainly at the amount calculated based on the retirement benefit obligation and the fair value of the plan assets as of balance sheet date.
(i) Allocation of expected benefit payments
When calculating retirement benefit obligation, the benefit formula method is used to allocate expected benefit payments to the period.
(ii) Actuarial differences and prior service cost
Prior service cost is amortized through the straight-line method over a term that does not exceed the average remaining service period of employees who are expected to receive benefits under the plans (10 years).

Net actuarial gains or losses are amortized from the following year through the straight-line method over a term that does not exceed the average remaining service period of employees who are expected to receive benefits under the plans (10 years).
(iii) Accounting treatment for unrecognized actuarial gains and losses and unrecognized prior service cost
Unrecognized actuarial gains and losses and unrecognized prior service cost are adjusted for tax effects and then recorded in retirement benefits liability adjustments under accumulated other comprehensive income in the net assets portion of the consolidated balance sheets.

**(12) Profit and Dividends per Share**
Profit attributable to owners of the parent per share is based upon the weighted- average number of shares of common stock outstanding during each fiscal year.

Cash dividends per share shown for each year in the accompanying consolidated statements of income represent dividends approved or declared as applicable to the respective years.

**(13) Reclassification of Accounts**
Prior years' amounts have been reclassified to conform with the current year's presentation.

**(14) Research and Development Expenses**
Research and development expenses are recognized as an expense when incurred in accordance with Japanese accounting standards.

**(15) Accounting Changes**
Adoption of Accounting Standard for Business Combinations, etc.
The Companies adopted "Accounting Standard for Business Combinations" (ASBJ Statement No. 21, September 13, 2013), "Accounting Standard for Consolidated Financial Statements" (ASBJ Statement No. 22, September 13, 2013), and "Accounting Standard for Business Divestitures" (ASBJ Statement No. 7, September 13, 2013) effective from April 1, 2015. As a result, the Company have changed the presentation of net income to profit and the presentation of minority interests in consolidated subsidiary to non-controlling interests.

## Note 03 United States Dollar Amounts

The accompanying consolidated financial statements are expressed in yen, and solely for the convenience of the reader, have been translated into U.S. dollars at the rate of ¥113=U.S.$1, the approximate rate of exchange prevailing at March 31, 2016. This translation should not be construed as a representation that all amounts shown could be converted into U.S. dollars at such a rate.

## Note 04 Cash and Cash Equivalents

Cash and cash equivalents at March 31, 2015 and 2016 are as follows:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2016** | 2015 | **2016** |
| Cash on hand and in banks | **¥25,666** | ¥27,242 | **$227,133** |
| Marketable securities | **24,476** | 25,132 | **216,602** |
| Time deposits with original maturities of over three months | **(47)** | (50) | **(416)** |
| Marketable securities with maturities of over three months | **—** | (182) | **—** |
| Cash and cash equivalents | **¥50,095** | ¥52,142 | **$443,319** |

## Note 05 Financial Instruments

**Overview**

(1) Policy for financial instruments

The Companies manage temporary cash surpluses through low-risk financial assets. Further, the Companies raise short-term capital through bank borrowings. The Companies use derivatives for the purpose of reducing risk arising from fluctuations in foreign currency exchange rates and do not enter into derivatives for speculative or trading purposes.

(2) Types of financial instruments and related risk

Trade receivables—notes and accounts receivable—are exposed to credit risk in relation to customers. In accordance with the internal policies for managing credit risk of the Companies arising from receivables, each related division monitors credit worthiness of their main customers periodically, and monitors due dates and outstanding balances by individual customer.

Marketable securities and investments in securities are exposed to market risk. Those securities are composed of mainly the shares of common stock of other companies with which the Companies have business relationships. The market value of these securities is periodically reported to the Board of Directors.

(3) Supplementary explanation of the estimated fair value of financial instruments

The fair value of financial instruments is based on their quoted market price, if available. When there is no quoted market price available, fair value is reasonably estimated. Since various assumptions and factors are reflected in estimating the fair value, different assumptions and factors could result in a different fair value.

**Estimated Fair Value of Financial Instruments**

Carrying value of financial instruments on the consolidated balance sheets as of March 31, 2015 and 2016 and unrealized gains (losses) are shown in the following tables. The following does not include financial instruments for which it is extremely difficult to determine the fair value. (Please refer to *2 below.)

| | Millions of yen | | |
|---|---|---|---|
| **As of March 31, 2016** | Carrying value | Estimated fair value | Unrealized gains (losses) |
| **Assets:** | | | |
| Cash on hand and in banks | **¥ 25,666** | **¥ 25,666** | **¥—** |
| Notes and accounts receivable | **24,967** | **24,967** | **—** |
| Marketable securities and investments in securities | **85,034** | **85,034** | **—** |
| Total | **¥135,667** | **¥135,667** | **¥—** |
| Derivatives | **¥ —** | **¥ —** | **¥—** |

| | Millions of yen | | |
|---|---|---|---|
| As of March 31, 2015 | Carrying value | Estimated fair value | Unrealized gains (losses) |
| **Assets:** | | | |
| Cash on hand and in banks | ¥ 27,242 | ¥ 27,242 | ¥— |
| Notes and accounts receivable | 23,676 | 23,676 | — |
| Marketable securities and investments in securities | 77,636 | 77,636 | — |
| Total | ¥128,554 | ¥128,554 | ¥— |
| Derivatives | ¥ — | ¥ — | ¥— |

| | Thousands of U.S. dollars | | |
|---|---|---|---|
| **As of March 31, 2016** | Carrying value | Estimated fair value | Unrealized gains (losses) |
| **Assets:** | | | |
| Cash on hand and in banks | **$ 227,133** | **$ 227,133** | **$—** |
| Notes and accounts receivable | **220,947** | **220,947** | **—** |
| Marketable securities and investments in securities | **752,513** | **752,513** | **—** |
| Total | **$1,200,593** | **$1,200,593** | **$—** |
| Derivatives | **$ —** | **$ —** | **$—** |

*1: Methods to determine the estimated fair value of financial instruments and other matters related to securities and derivative transactions

Cash on hand and in banks and notes and accounts receivable

Since these items are settled in a short period of time, their carrying value approximates fair value.

Marketable securities and investments in securities

The fair value of stocks is based on quoted market prices. For information on securities classified by holding purpose, please refer to Note 6 Securities.

*2: Financial instruments for which it is extremely difficult to determine the fair value are as follows:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2016** | 2015 | **2016** |
| Unlisted stocks | **¥1,024** | ¥1,024 | **$9,062** |
| Investments in partnerships | **139** | 213 | **1,230** |
| Investments in unconsolidated subsidiaries | **580** | 641 | **5,133** |

Because no quoted market price is available and it is extremely difficult to determine the fair value, the above financial instruments are not included in "Marketable securities and investments in securities."

*3: Redemption schedule for receivables and marketable securities with maturities at March 31, 2015 and 2016 are as follows:

| | Millions of yen | | | |
|---|---|---|---|---|
| **As of March 31, 2016** | Due in one year or less | Due after one year through five years | Due after five years through ten years | Due after ten years |
| **Assets:** | | | | |
| Cash on hand and in banks | **¥25,666** | **¥ —** | **¥ —** | **¥ —** |
| Notes and accounts receivable | **24,957** | **10** | **—** | **—** |
| Marketable securities and investments in securities | **24,478** | **838** | **1,456** | **418** |
| Total | **¥75,101** | **¥848** | **¥1,456** | **¥418** |

| | Millions of yen | | | |
|---|---|---|---|---|
| As of March 31, 2015 | Due in one year or less | Due after one year through five years | Due after five years through ten years | Due after ten years |
| **Assets:** | | | | |
| Cash on hand and in banks | ¥27,242 | ¥ — | ¥ — | ¥— |
| Notes and accounts receivable | 23,676 | — | — | — |
| Marketable securities and investments in securities | 25,098 | 760 | 891 | — |
| Total | ¥76,016 | ¥760 | ¥891 | ¥— |

| | Thousands of U.S. dollars | | | |
|---|---|---|---|---|
| **As of March 31, 2016** | Due in one year or less | Due after one year through five years | Due after five years through ten years | Due after ten years |
| **Assets:** | | | | |
| Cash on hand and in banks | **$227,133** | **$ —** | **$ —** | **$ —** |
| Notes and accounts receivable | **220,859** | **88** | **—** | **—** |
| Marketable securities and investments in securities | **216,619** | **7,416** | **12,885** | **3,699** |
| Total | **$664,611** | **$7,504** | **$12,885** | **$3,699** |

## Note 06 Securities

The acquisition cost, carrying amount, and gross unrealized holding gains and losses for securities with fair value by security type at March 31, 2015 and 2016 are as follows:

| | Millions of yen | | | |
|---|---|---|---|---|
| | **2016** | | | |
| | Acquisition cost | Carrying amount | Gross unrealized holding gains | Gross unrealized holding losses |
| Equity securities | **¥18,399** | **¥55,247** | **¥37,222** | **¥374** |
| Corporate debt securities | **100** | **101** | **1** | **—** |
| Other | **29,443** | **29,685** | **268** | **26** |
| Total | **¥47,942** | **¥85,033** | **¥37,491** | **¥400** |

| | Millions of yen | | | |
|---|---|---|---|---|
| | 2015 | | | |
| | Acquisition cost | Carrying amount | Gross unrealized holding gains | Gross unrealized holding losses |
| Equity securities | ¥17,692 | ¥48,596 | ¥30,906 | ¥ 2 |
| Corporate debt securities | 200 | 202 | 2 | — |
| Other | 28,453 | 28,838 | 392 | 7 |
| Total | ¥46,345 | ¥77,636 | ¥31,300 | ¥ 9 |

| | Thousands of U.S. dollars | | | |
|---|---|---|---|---|
| | 2016 | | | |
| | Acquisition cost | Carrying amount | Gross unrealized holding gains | Gross unrealized holding losses |
| Equity securities | **$162,823** | **$488,912** | **$329,398** | **$3,309** |
| Corporate debt securities | **885** | **894** | **9** | **—** |
| Other | **260,557** | **262,699** | **2,372** | **230** |
| Total | **$424,265** | **$752,505** | **$331,779** | **$3,539** |

Unlisted stocks are not included in the above table because there were no quoted market prices available and it is extremely difficult to determine the fair value.

Sales proceeds of securities classified as other securities and the gross realized gains and losses for the years ended March 31, 2015 and 2016 are as follows:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2016** | 2015 | **2016** |
| Sales proceeds | **¥ 0** | ¥28 | **$ 0** |
| Gross realized gains | **0** | 7 | **0** |
| Gross realized losses | **—** | — | **—** |

## Note 07 Inventories

Inventories at March 31, 2015 and 2016 are as follows:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2016** | 2015 | **2016** |
| Merchandise | **¥ 1,373** | ¥ 1,494 | **$ 12,150** |
| Finished goods | **3,405** | 3,450 | **30,133** |
| Work-in-process | **2,625** | 1,563 | **23,230** |
| Raw materials | **9,877** | 8,067 | **87,407** |
| Supplies | **96** | 72 | **850** |
| Total | **¥17,376** | ¥14,646 | **$153,770** |

## Note 08 Short-Term Bank Loans and Long-Term Debt

Short-term bank loans outstanding at March 31, 2015 and 2016 represent one-year notes issued by the Companies to banks. Short-term bank loans made during the years ended March 31, 2015 and 2016 bore interest at an average annual rate of 1.11% and 1.11%, respectively.

Long-term debt outstanding of the Companies at March 31, 2015 and 2016 are as follows:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2016** | 2015 | **2016** |
| Non-secured loans with financial institutions, bearing interest at rates ranging from 0.00% to 2.20% due from 2015 to 2021 | **¥1,574** | ¥1,549 | **$13,929** |
| Less: current maturities due within one year | **(85)** | (85) | **(752)** |
| Total | **¥1,489** | ¥1,464 | **$13,177** |

The aggregate annual maturities of long-term debt outstanding at March 31, 2016 are as follows:

| Year ending March 31 | Millions of yen | Thousands of U.S. dollars |
|---|---|---|
| 2018 | ¥ 70 | $ 620 |
| 2019 | 28 | 248 |
| 2020 | 18 | 159 |
| 2021 and thereafter | 1,373 | 12,150 |
| Total | ¥1,489 | $13,177 |

## Note 09 Income Taxes

Deferred tax assets (both current and non-current) at March 31, 2015 and 2016 are as follows:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2016** | 2015 | **2016** |
| **Deferred Tax Assets:** | | | |
| Prepaid research and development expenses | **¥ 2,491** | ¥ 2,089 | **$ 22,044** |
| Net defined benefit liability | **1,838** | 738 | **16,266** |
| Accrued bonuses to employees | **671** | 706 | **5,938** |
| Write-down of securities | **625** | 636 | **5,531** |
| Inventory assets | **408** | 461 | **3,611** |
| Impairment loss | **193** | 178 | **1,708** |
| Accrued enterprise tax | **178** | 149 | **1,575** |
| Payment of retirement benefits to directors and corporate auditors | **151** | 154 | **1,336** |
| Reserve for sales rebates | **116** | 111 | **1,027** |
| Other | **870** | 890 | **7,699** |
| Total gross deferred tax assets | **7,541** | 6,112 | **66,735** |
| Valuation allowance | **(1,159)** | (1,169) | **(10,257)** |
| Total deferred tax assets | **¥ 6,382** | ¥ 4,943 | **$ 56,478** |
| **Deferred Tax Liabilities:** | | | |
| Unrealized gains on available-for-sale securities | **¥(11,172)** | ¥(9,815) | **$(98,867)** |
| Other | **(14)** | (15) | **(124)** |
| Total deferred tax liabilities | **(11,186)** | (9,830) | **(98,991)** |
| Deferred tax assets (liabilities), net | **¥ (4,804)** | ¥(4,887) | **$(42,513)** |

Reconciliation of the actual tax rate for the years ended March 31, 2015 and 2016 are as follows:

| | **2016** | 2015 |
|---|---|---|
| Effective statutory tax rate | **32.9%** | 35.4% |
| Adjustments: | | |
| Entertainment expenses and other non-deductibles | **0.9** | 1.3 |
| Dividend income not taxable | **(0.5)** | (1.3) |
| Tax benefits due to research and development expenses | **(9.9)** | (9.8) |
| Per capital levy of local inhabitants taxes | **0.7** | 0.8 |
| Valuation allowance | **0.6** | (0.1) |
| Tax effect from change in tax rate by tax reform, etc. | **2.3** | 4.5 |
| Other | **(0.6)** | 0.5 |
| Actual tax rate | **26.4%** | 31.3% |

Following the establishment of the Act for Partial Revision of the Income Tax Act, etc., and the Act for Partial Revision of the Local Taxation Act, etc., in the National Diet on March 29, 2016, the effective statutory tax rate used to calculate the Companies' deferred tax assets and liabilities (limited to those to be eliminated on and after April 1, 2016) was changed from 32.1% to 30.7% and 30.5% for the temporary differences expected to be realized or settled in the year beginning April 1, 2016, and for the temporary differences expected to be realized or settled from April 1, 2018, respectively.

The effect of the effective statutory tax rate reduction was to decrease deferred tax liabilities after offsetting deferred tax assets by ¥292 million ($2,584 thousand) and retirement benefits liability adjustments by ¥40 million ($354 thousand), and to increase deferred income taxes expense by ¥253 million ($2,239 thousand) and unrealized holding gains on securities by ¥586 million ($5,186 thousand) as of and for the year ended March 31,2016.

## Note 10 Funded Defined Benefits Plans

**General Outline of Retirement Benefits Plans Implemented**

The Companies have introduced cash balance plans into their defined benefits corporate pension plans. In certain cases, the Group pays additional retirement benefits for employees that are not included in the retirement benefit obligations determined actuarially in accordance with the accounting standard for retirement benefits.

For the years ended March 31, 2015 and 2016

(i) Reconciliation of defined benefit obligation at beginning and end of period

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2016** | 2015 | **2016** |
| Defined benefit obligation at beginning of period | **¥16,523** | ¥18,347 | **$146,221** |
| Cumulative effects of changes in accounting policies | **—** | 637 | **—** |
| Restated balance at beginning of period | **16,523** | 18,984 | **146,221** |
| Service cost | **742** | 753 | **6,566** |
| Interest cost | **173** | 184 | **1,531** |
| Actuarial gains and losses incurred this period | **3,701** | (234) | **32,752** |
| Prior service cost incurred this period* | **—** | (2,551) | **—** |
| Retirement benefits paid | **(486)** | (613) | **(4,300)** |
| Defined benefit obligation at end of period | **¥20,653** | ¥16,523 | **$182,770** |

* Prior service cost incurred previous period arose from the completion of transitional measures related to the reevaluation rate of cash balance plans.

(ii) Reconciliation of balance of plan assets at beginning and end of period

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2016** | 2015 | **2016** |
| Plan assets at beginning of period | **¥14,244** | ¥12,550 | **$126,053** |
| Expected return on plan assets | **356** | 314 | **3,150** |
| Actuarial gains and losses incurred this period | **(570)** | 923 | **(5,044)** |
| Employer contribution | **1,013** | 989 | **8,965** |
| Retirement benefits paid | **(404)** | (532) | **(3,575)** |
| Plan assets at end of period | **¥14,639** | ¥14,244 | **$129,549** |

(iii) Reconciliation of defined benefit obligation and plan assets with net defined benefit liability and asset reflected on the consolidated balance sheets

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2016** | 2015 | **2016** |
| Defined benefit obligation for funded plan | **¥ 20,653** | ¥ 16,523 | **$ 182,770** |
| Plan assets | **(14,639)** | (14,244) | **(129,549)** |
| Net amount of defined benefit liability and asset on the consolidated balance sheets | **6,014** | 2,279 | **53,221** |
| | | | |
| Defined benefit liability | **6,014** | 2,279 | **53,221** |
| Net amount of defined benefit liability and asset on the consolidated balance sheets | **¥ 6,014** | ¥ 2,279 | **$ 53,221** |

(iv) The components of retirement benefit expense

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2016** | 2015 | **2016** |
| Service cost | **¥ 742** | ¥ 753 | **$ 6,566** |
| Interest cost | **173** | 184 | **1,531** |
| Expected return on plan assets | **(356)** | (314) | **(3,150)** |
| Amortization of actuarial gains and losses | **267** | 351 | **2,363** |
| Amortization of prior service cost | **(520)** | (531) | **(4,602)** |
| Other | **11** | 49 | **97** |
| Retirement benefit expense | **¥ 317** | ¥ 492 | **$ 2,805** |

(v) The components of retirement benefit liability adjustment included in other comprehensive income (before tax effect)

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2016** | 2015 | **2016** |
| Prior service cost | **¥ (520)** | ¥2,021 | **$ (4,602)** |
| Actuarial gains and losses | **(4,004)** | 1,508 | **(35,433)** |
| Total | **¥(4,524)** | ¥3,529 | **$(40,035)** |

(vi) The components of retirement benefit liability adjustment included in accumulated other comprehensive income (before tax effect)

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2016** | 2015 | **2016** |
| Unrecognized prior service cost | **¥(2,041)** | ¥(2,561) | **$(18,062)** |
| Unrecognized actuarial gains and losses | **4,578** | 574 | **40,513** |
| Total | **¥ 2,537** | ¥(1,987) | **$ 22,451** |

(vii) Plan assets information

Breakdown of plan assets

Ratio of each component of plan assets to amount of total pension assets

| | **2016** | 2015 |
|---|---|---|
| Debt securities | **21%** | 19% |
| Equity securities | **26** | 31 |
| General accounts | **52** | 49 |
| Other | **1** | 1 |
| Total | **100%** | 100% |

The expected return on assets has been estimated based on the anticipated allocation to each asset class and the expected long-term returns on assets held in each category.

(viii) Assumptions used in accounting for the above plans (discount rate is displayed as a weighted average)

| | **2016** | 2015 |
|---|---|---|
| Discount rate | **0.4%** | 1.5% |
| Expected rate of return on plan assets | **2.5%** | 2.5% |

## Note 11 Other Comprehensive Income

Amounts of recycling and income tax relating to other comprehensive income for the years ended March 31, 2015 and 2016 were as follows:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2016** | 2015 | **2016** |
| Unrealized holding gains on securities: | | | |
| Amount recognized in the year under review | **¥ 5,820** | ¥11,966 | **$ 51,503** |
| Amount of recycling | **(1)** | (8) | **(8)** |
| Before income tax effect adjustment | **5,819** | 11,958 | **51,495** |
| Amount of income tax effect | **(1,392)** | (3,164) | **(12,318)** |
| Unrealized holding gains on securities | **4,427** | 8,794 | **39,177** |
| Retirement benefits liability adjustments: | | | |
| Amount recognized in the year under review | **(4,271)** | 3,453 | **(37,796)** |
| Amount of recycling | **(253)** | 76 | **(2,239)** |
| Before income tax effect adjustment | **(4,524)** | 3,529 | **(40,035)** |
| Amount of income tax effect | **1,412** | (1,184) | **12,495** |
| Retirement benefits liability adjustments | **(3,112)** | 2,345 | **(27,540)** |
| Total other comprehensive income | **¥ 1,315** | ¥11,139 | **$ 11,637** |

## Note 12 Contingent Liabilities

No corresponding items.

## Note 13 Government Grants

For the years ended March 31, 2015 and 2016

Government grants of ¥798 million ($7,062 thousand) for buildings and ¥113 million ($1,000 thousand) for land are deducted in calculating the carrying amounts of these assets.

## Note 14 Segment Information

**(1) Overview of Business Segments**

The business segments of the Companies are components for which discrete financial information is available and whose operating results are regularly reviewed by the Board of Directors to make decisions about resource allocation and to assess their performance.

As the Companies' primary business is the pharmaceutical business, its reportable segment is the pharmaceuticals segment.

**(2) Method of Calculating Sales and Profit (Loss), Identifiable Assets / Liabilities, and Other Items by Business Segment**

The accounting procedure for business segments reported is the same as that described in Note 2 Summary of Significant Accounting Policies.

Segment profit is calculated based on operating income.

Intersegment sales are recognized based on the price in an arm's-length transaction.

**(3) Information on Sales and Profit (Loss), Identifiable Assets / Liabilities, and Other Items by Business Segment**

| | Millions of yen | | | |
|---|---|---|---|---|
| | Business segments | | | |
| **As of March 31, 2016** | Pharmaceuticals | Total | Other*1 | Total |
| Net sales: | | | | |
| Sales to third parties | **¥ 61,822** | **¥ 61,822** | **¥ 9,472** | **¥ 71,294** |
| Intersegment sales and transfers | **—** | **—** | **5,495** | **5,495** |
| Total | **¥ 61,822** | **¥ 61,822** | **¥14,967** | **¥ 76,789** |
| Segment profit | **¥ 9,610** | **¥ 9,610** | **¥ 669** | **¥ 10,279** |
| Segment assets | **¥184,209** | **¥184,209** | **¥11,145** | **¥195,354** |
| Other items: | | | | |
| Depreciation*2 | **¥ 2,142** | **¥ 2,142** | **¥ 341** | **¥ 2,483** |
| Increase of property, plant and equipment and intangible assets*2 | **3,479** | **3,479** | **306** | **3,785** |

*1: The Other segment is not a reportable segment; it includes sales of materials and other goods, information solution services and construction subcontracting.
*2: Depreciation includes the amortization of long-term prepaid expenses. Increase of property, plant and equipment and intangible assets reflects the increase in long-term prepaid expenses.

| | Millions of yen | | | |
|---|---|---|---|---|
| | Business segments | | | |
| As of March 31, 2015 | Pharmaceuticals | Total | Other*1 | Total |
| Net sales: | | | | |
| Sales to third parties | ¥ 59,694 | ¥ 59,694 | ¥10,417 | ¥ 70,111 |
| Intersegment sales and transfers | — | — | 5,460 | 5,460 |
| Total | ¥ 59,694 | ¥ 59,694 | ¥15,877 | ¥ 75,571 |
| Segment profit | ¥ 7,626 | ¥ 7,626 | ¥ 722 | ¥ 8,348 |
| Segment assets | ¥173,576 | ¥173,576 | ¥10,076 | ¥183,652 |
| Other items: | | | | |
| Depreciation*2 | ¥ 2,009 | ¥ 2,009 | ¥ 328 | ¥ 2,337 |
| Increase of property, plant and equipment and intangible assets*2 | 2,127 | 2,127 | 342 | 2,469 |

*1: The Other segment is not a reportable segment; it includes sales of materials and other goods, information solution services and construction subcontracting.
*2: Depreciation includes the amortization of long-term prepaid expenses. Increase of property, plant and equipment and intangible assets reflects the increase in long-term prepaid expenses.

| | Thousands of U.S. dollars | | | |
|---|---|---|---|---|
| | Business segments | | | |
| **As of March 31, 2016** | Pharmaceuticals | Total | Other*1 | Total |
| Net sales: | | | | |
| Sales to third parties | **$ 547,097** | **$ 547,097** | **$ 83,823** | **$ 630,920** |
| Intersegment sales and transfers | **—** | **—** | **48,628** | **48,628** |
| Total | **$ 547,097** | **$ 547,097** | **$132,451** | **$ 679,548** |
| Segment profit | **$ 85,044** | **$ 85,044** | **$ 5,920** | **$ 90,964** |
| Segment assets | **$1,630,168** | **$1,630,168** | **$ 98,629** | **$1,728,797** |
| Other items: | | | | |
| Depreciation*2 | **$ 18,956** | **$ 18,956** | **$ 3,017** | **$ 21,973** |
| Increase of property, plant and equipment and intangible assets*2 | **30,788** | **30,788** | **2,708** | **33,496** |

*1: The Other segment is not a reportable segment; it includes sales of materials and other goods, information solution services and construction subcontracting.
*2: Depreciation includes the amortization of long-term prepaid expenses. Increase of property, plant and equipment and intangible assets reflects the increase in long-term prepaid expenses.

**(4) Reconciliation Items between Segment Information and the Consolidated Financial Statements**

(i) Major items for adjustments

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2016** | 2015 | **2016** |
| Net sales: | | | |
| Total of business segments | **¥ 61,822** | ¥ 59,694 | **$ 547,097** |
| Other business sales | **14,967** | 15,877 | **132,451** |
| Elimination of intersegment transactions | **(5,495)** | (5,460) | **(48,628)** |
| Reported on consolidated financial statements | **¥ 71,294** | ¥ 70,111 | **$ 630,920** |
| Segment profit: | | | |
| Total of business segments | **¥ 9,610** | ¥ 7,626 | **$ 85,044** |
| Other business profit | **669** | 722 | **5,920** |
| Elimination of intersegment transactions | **36** | 63 | **319** |
| Adjustments to depreciable assets | **(25)** | (58) | **(221)** |
| Other adjustments | **(16)** | (19) | **(141)** |
| Reported on consolidated financial statements | **¥ 10,274** | ¥ 8,334 | **$ 90,921** |
| Segment assets: | | | |
| Total of business segments | **¥184,209** | ¥173,576 | **$1,630,168** |
| Assets classified as “other” | **11,145** | 10,076 | **98,629** |
| Elimination of intersegment transactions | **(2,008)** | (2,167) | **(17,770)** |
| Reported on consolidated financial statements | **¥193,346** | ¥181,485 | **$1,711,027** |

(ii) Other items for adjustments

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2016** | 2015 | **2016** |
| Depreciation: | | | |
| Total of business segments | **¥2,142** | ¥2,009 | **$18,956** |
| Other segments | **341** | 328 | **3,017** |
| Adjustments | **(139)** | (133) | **(1,230)** |
| Reported on consolidated financial statements | **¥2,344** | ¥2,204 | **$20,743** |
| Increase of property, plant and equipment and intangible assets | | | |
| Total of business segments | **¥3,479** | ¥2,127 | **$30,788** |
| Other segments | **306** | 342 | **2,708** |
| Adjustments | **(181)** | (246) | **(1,602)** |
| Reported on consolidated financial statements | **¥3,604** | ¥2,223 | **$31,894** |

**(5) Related Information**

(i) Product and service information

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2016** | 2015 | **2016** |
| Pharmaceuticals | **¥61,822** | ¥59,694 | **$547,097** |
| Other | **9,472** | 10,417 | **83,823** |
| Total | **¥71,294** | ¥70,111 | **$630,920** |

(ii) Geographical information

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2016** | 2015 | **2016** |
| Japan | **¥64,063** | ¥62,854 | **$566,929** |
| Europe | **4,388** | 3,090 | **38,832** |
| Other foreign countries | **2,843** | 4,167 | **25,159** |
| Total | **¥71,294** | ¥70,111 | **$630,920** |

* Net sales information above is based on customer location.

(iii) Property,plant and equipment

There are no corresponding items as the Company does not possess any property, plant or equipment outside of Japan.

(iv) Major customer information

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2016** | 2015 | **2016** |
| Alfresa Corporation | **¥11,436** | ¥10,789 | **$101,204** |
| SUZUKEN CO., LTD. | **9,826** | 9,347 | **86,956** |
| MEDICEO CORPORATION | **8,024** | 7,633 | **71,009** |

* Related segment for each major customer is the pharmaceuticals segment.

## Note 15 Related Party Transactions

For the year ended March 31, 2016
No corresponding items.

For the year ended March 31, 2015
Transactions with executives, main individual stockholders, etc.

| Category | Name of party | Location | Capital or investment amount (millions of yen) | Business/ Occupation | Ratio of voting rights holding (held) (%) | Relationship with related party | Details of transaction | Amount transaction (millions of yen) | Account | Outstanding amount at the end of the year (millions of yen) |
|---|---|---|---|---|---|---|---|---|---|---|
| Executives | Mutsuo Kanzawa | — | — | Chairman and CEO of the Company | 3.13% (held) | Chairman and CEO of the Company | Acquisition of treasury stock | 7,775 | — | — |

*1: Terms and conditions of the transaction and its policies: The above transaction is conducted through the Tokyo Stock Exchange Trading Network System for Off-Auction Own Share Repurchase Trading (ToSTNeT-3).
*2: Ratio of voting rights holding (held) is based on total shares issued net of treasury stock.

## Note 16 Selling, General and Administrative Expenses

Selling, general and administrative expenses for the years ended March 31, 2015 and 2016 are as follows:

| | Millions of yen | | Thousands of U.S. dollars |
|---|---|---|---|
| | **2016** | 2015 | **2016** |
| Payroll costs | **¥ 9,666** | ¥ 9,509 | **$ 85,540** |
| Research and development expenses | **14,106** | 14,488 | **124,832** |
| Depreciation | **611** | 632 | **5,407** |
| Other | **13,057** | 13,082 | **115,548** |
| Total | **¥37,440** | ¥37,711 | **$331,327** |

## Note 17 Subsequent Events

No corresponding items.

# Independent Auditor's Report

Ernst & Young ShinNihon LLC
3-1-1 Ote, Matsumoto-shi
Nagano, Japan 390-0874
Tel: +81 263 31 8720
Fax: +81 263 31 8721

Building a better working world

## Independent Auditor's Report

The Board of Directors
Kissei Pharmaceutical Co., Ltd.

We have audited the accompanying consolidated financial statements of Kissei Pharmaceutical Co., Ltd. and its consolidated subsidiaries, which comprise the consolidated balance sheet as at March 31, 2016, and the consolidated statements of income, comprehensive income, changes in net assets, and cash flows for the year then ended and a summary of significant accounting policies and other explanatory information, all expressed in Japanese yen.

*Management's Responsibility for the Consolidated Financial Statements*

Management is responsible for the preparation and fair presentation of these consolidated financial statements in accordance with accounting principles generally accepted in Japan, and for designing and operating such internal control as management determines is necessary to enable the preparation and fair presentation of the consolidated financial statements that are free from material misstatement, whether due to fraud or error.

*Auditor's Responsibility*

Our responsibility is to express an opinion on these consolidated financial statements based on our audit. We conducted our audit in accordance with auditing standards generally accepted in Japan. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free from material misstatement.

An audit involves performing procedures to obtain audit evidence about the amounts and disclosures in the consolidated financial statements. The procedures selected depend on the auditor's judgment, including the assessment of the risks of material misstatement of the consolidated financial statements, whether due to fraud or error. The purpose of an audit of the consolidated financial statements is not to express an opinion on the effectiveness of the entity's internal control, but in making these risk assessments the auditor considers internal controls relevant to the entity's preparation and fair presentation of the consolidated financial statements in order to design audit procedures that are appropriate in the circumstances. An audit also includes evaluating the appropriateness of accounting policies used and the reasonableness of accounting estimates made by management, as well as evaluating the overall presentation of the consolidated financial statements.

We believe that the audit evidence we have obtained is sufficient and appropriate to provide a basis for our audit opinion.

*Opinion*

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of Kissei Pharmaceutical Co., Ltd. and its consolidated subsidiaries as at March 31, 2016, and their consolidated financial performance and cash flows for the year then ended in conformity with accounting principles generally accepted in Japan.

*Convenience Translation*

We have reviewed the translation of these consolidated financial statements into U.S. dollars, presented for the convenience of readers, and, in our opinion, the accompanying consolidated financial statements have been properly translated on the basis described in Note 3.

June29, 2016
Matsumoto, Japan

Ernst & Young ShinNihon LLC

# Corporate Data

As of March 31, 2016

**Head Office:**
19-48, Yoshino, Matsumoto City,
Nagano 399-8710, Japan
Telephone: +81-263-25-9081

**Tokyo Head Office:**
8-9, Nihonbashi-Muromachi 1-chome,
Chuo-ku, Tokyo 103-0022, Japan
Telephone: +81-3-3279-2761

**Tokyo Head Office (Koishikawa):**
1-3, Koishikawa 3-chome, Bunkyo-ku,
Tokyo 112-0002, Japan
Telephone: +81-3-5684-3530

**Date of Establishment:**
August 9, 1946

**Capital:**
¥24,357 million

**Number of Employees:**
1,536 (Non-consolidated)

**Central Research Laboratories:**
Azumino City, Nagano

**Toxicological Laboratories:**
Azumino City, Nagano

**Joetsu Chemical Laboratories:**
Joetsu City, Niigata

**Pharmaceutical Laboratories:**
Azumino City, Nagano

**Plants:**
Matsumoto City, Nagano
Shiojiri City, Nagano

**Nutritional Business Center:**
Shiojiri City, Nagano

**Information Center:**
Matsumoto City, Nagano

**Subsidiaries:**
Consolidated Subsidiaries
Kissei Shoji Co., Ltd.
Kissei Comtec Co., Ltd.
Hashiba Technos Co., Ltd.

Non-Consolidated Subsidiaries
Kissei America, Inc.
Mitsui Kanko Co., Ltd.
Planet Computer Technology
(Beijing) Co., Ltd.

**Common Stock:**
Authorized: 227,000,000 shares
Issued: 54,311,185 shares

**Number of Shareholders:**
4,093 (Year-on-year change: 630 increase)

# Investor Information

As of March 31, 2016

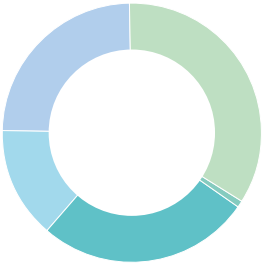
**Principal Shareholders:**

| | Number of shares held (Hundreds) | Voting rights (%) |
|---|---|---|
| The Dai-ichi Life Insurance Company, Limited | 32,000 | 6.5 |
| Kanzawa Limited | 31,783 | 6.5 |
| Japan Trustee Services Bank, Ltd. (Trust account) | 27,168 | 5.6 |
| The Hachijuni Bank, Ltd. | 24,435 | 5.0 |
| Mizuho Bank, Ltd. | 24,434 | 5.0 |
| Mutsuo Kanzawa | 15,360 | 3.1 |
| The Master Trust Bank of Japan, Ltd. (Trust account) | 12,706 | 2.6 |
| Kissei Group Employee Stockholders Committee | 12,696 | 2.6 |
| Nabelin Co., Ltd. | 12,223 | 2.5 |
| The Nagano Bank, Ltd. | 11,261 | 2.3 |

* Kissei holds 53,836 hundred shares of treasury stock but is not included in the above list of principal shareholders. Further, the calculation of voting rights percentages is based on total shares issued net of treasury stock.

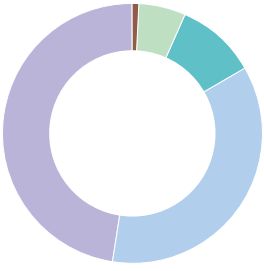
**Composition of Shareholders:**

**By Category**



**34.3%** Financial institutions: 48 (18,647 thousand shares)
**0.7%** Securities companies: 38 (345 thousand shares)
**26.7%** Other companies: 197 (14,497 thousand shares)
**14.0%** Non-Japanese institutions and individuals: 223 (7,615 thousand shares)
**24.3%** Individuals and others: 3,587 (13,207 thousand shares)

**By Number of Shares Held**



**1.1%** 1–999 shares: 2,469 (588 thousand shares)
**5.6%** 1,000–9,999 shares: 1,367 (3,023 thousand shares)
**10.2%** 10,000–99,999 shares: 185 (5,580 thousand shares)
**35.6%** 100,000–999,999 shares: 61 (19,330 thousand shares)
**47.5%** 1,000,000 and over shares: 11 (25,790 thousand shares)

KISSEI PHARMACEUTICAL CO., LTD.
19-48, Yoshino, Matsumoto City, Nagano 399-8710, Japan
URL: http://www.kissei.co.jp/

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